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**SELF-EMPLOYED PEOPLE:
A LITERATURE REVIEW FOR THE
CONTRIBUTIONS AGENCY**

Carried out on behalf of the Department of Social Security

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First Published 1997

ISBN 1-85197-826-7

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ACKNOWLEDGEMENTS

The authors are grateful for interest and assistance from Jim Rynn and John Williams at the Contributions Agency, and Rebecca Goldman and Arthur Fleiss at the Social Research Branch of the Department of Social Security. Discussions with administrative staff at the Contributions Agency at Longbenton, Newcastle upon Tyne were valuable, as was the time spent with staff in York Contributions Agency.

At the University of York, our colleagues Janet Ford and Roger Burrows made useful suggestions at the beginning of our work.

The Institute for Employment Studies (formerly the Institute of Manpower Studies) kindly gave permission for reproduction of Figures 3.2 and 3.3 from *Self-employment and the Distribution of Income* (1994) by N. Meager, G. Court and J. Moralee, and these appear as Figures 5.1 and 5.2 in this review.

EXECUTIVE SUMMARY

SELF-EMPLOYED PEOPLE: A LITERATURE REVIEW FOR THE CONTRIBUTIONS AGENCY

There is thought to be considerable under-collection of Class 2 National Insurance contributions (NICs) from self-employed people, arising from non-registration and debt. The Department of Social Security has commissioned a literature review of the characteristics of self-employed people. By looking at what is already known about self-employed people, it may be possible to gain useful insights into possible reasons for under-collection of Class 2 contributions.

Chapter One: Defining self-employment

Legal definitions

- legislative definitions of self-employed people are couched in negative terminology by reference to employees, and also depend on the contract of service, a legal construct defined in common law.
- the Inland Revenue and the Department of Social Security use the same body of general case law. Apart from a small number of specific occupations, no concise definitions of self-employment have emerged, however.
- some ambiguities and confusions remain, and a number of 'grey areas', where distinctions between self-employed people and employees are controversial.

A sociological approach

- the traditional sociological approach, within theoretical frameworks of industrial production and class, was to see self-employment as an anachronistic form of work.

- self-employed people were allocated to a separate class location - the '*petit bourgeois*', who included craftspeople, independent professionals and small business proprietors.
- the nature of much of the recent increase in self-employment suggests that the distinction of the *petit bourgeois* is no longer tenable. Labour-only subcontracting, franchising, working as agents and freelancers, and some forms of homeworking, do not fit easily into the *petit bourgeois*/small business framework and have been called 'quasi-self-employment', or 'nominal self-employment'.
- issues of gender and ethnicity are receiving greater attention.
- there is a link to the economic literature through the concept of the 'small firm'.

Categorisations for statistical analysis

- definitions used in designing research instruments and analyses of data do not always reflect either legal or technical definitions, sociological categorisations, or people's self-perceptions.
- throughout this review of literature and research, those people discussed as self-employed will differ, according to the source of the information.

Chapter Two: The demographic characteristics of self-employed people

Growth and size of the population

- the proportion of all those in employment who are self-employed has fluctuated around 13 per cent since 1990.
- men have always formed the majority of the self-employed. By winter 1995/96 there were 2,421,000 men compared with 798,000 women.
- most of the recent growth has been of self-employed people without employees.

- most male self-employment is full-time; female self-employment is divided evenly between full- and part-time.

Personal characteristics of self-employed people

- the age profile of the self-employed is older than that of the working population generally, and peaks between the early 30s and mid-40s.
- only 3.0 per cent of men aged 16-19 years are self-employed, rising to 25.6 per cent of men in the five years prior to state pension age.
- self-employed workers are more likely to be married or cohabiting than to be single people.
- self-employment rates for women are generally higher among those with children.
- there is not a full picture of the health characteristics of the self-employed population.
- there is a greater likelihood of self-employment among people from Chinese, Pakistani/Bangladeshi and Indian backgrounds than White or Black backgrounds.

Geographical distribution of self-employment

- the incidence of self-employment is greatest in the South West and Wales and lowest in Scotland and the North of England.
- counties with over 100,000 self-employed people are Essex, Kent, West Yorkshire and Greater Manchester.

Flows into and out of self-employment

- entry and exit rates are higher for young people aged 16-24 years, and for women.

- men are more likely to have moved from employment to self-employment, but women are more likely to enter self-employment after a period of economic inactivity.
- women working part-time are the most likely to be recent entrants to self-employment.
- more than a quarter of all men, but only nine per cent of women, had experienced self-employment at some time during their working life.

Chapter Three: The kinds of work done by self-employed people

Occupational distribution

- men are more likely to be in manual occupations, and women more likely to be doing non-manual work.
- men are most likely to be in craft and related occupations, and managerial/administrative work; women most likely to be in managerial/administrative jobs, and associated professional and technical work.

Industrial sectors

- self-employed men are concentrated in three industrial sectors: construction; distribution, hotels and restaurants; and banking, finance and insurance.
- self-employed women are concentrated in distribution, hotels and restaurants; banking, finance and insurance; public administration, education and health, and other services.
- although relatively few people work in the agricultural sector and fishing, just over half of those who do, are self-employed.

Hours worked

- self-employed people tend to work longer hours, on average, than employees.

Qualifications and union membership

- there is rather a mixed picture of educational qualifications, and further information would be useful.
- union membership among men and women is low.

Chapter Four: The organisation of self-employed work

Forms of self-employment

- there is no satisfactory classification of different types of self-employed work. At present, these may be seen as a spectrum. At one end stands the traditional small business owner; at the other end, those whose situation is more like employees (the quasi-self-employed). In between are professionals, craft workers, family undertakings or 'ways of life', franchises and cooperatives.
- there are a number of studies of small businesses, focusing on particular groups such as shopkeepers, or female entrepreneurs. Small business, in general, is characterised by high levels of uncertainty.
- subcontracted workers may have employment patterns, and methods of payment, which make compliance with Class 2 NICs harder.
- business transactions within franchises may be complex, and hard to demonstrate.
- the majority of people working at home are probably self-employed. A wide range of activities and earnings are represented.
- those who choose to share the risks and rewards of work by working in partnership with others are more likely to be small business people or people working on their own account.

Self-employed people as employers and contractors

- less than a third of self-employed people have formal employees, and most of those who do employ five or fewer people.
- there are no statistics about use of non-employee labour (contract or homeworkers) by self-employed people.
- many self-employed people draw heavily on labour within the family, but it must not be assumed that this is 'irregular work'.

People who work as self-employed and employees

- there may be two in a hundred people who also work as an employee, and one employee in a hundred may have a second job as a self-employed person.

Chapter Five: The incomes and living standards of self-employed people

Measuring self-employed earnings

- there are a number of problems in measuring self-employed earnings, including:
 - the definition of self-employment
 - under-reporting of income
 - differential response rates
 - time-lags
 - concepts of earnings and measurement of profit
 - use of 'drawings' as a proxy for profit
 - derivation of profit by different accountancy techniques.

Distribution of income of self-employed people

- there is a wide variability of income, particularly for women.
- at the level of individual earnings, mean monthly net labour income of self-employed people in 1991 was greater than that of employees, (but not for women, considered separately).

- hourly earnings of self-employed people without employees in 1992 were lower than those of employees.
- analysis of Inland Revenue data on gross individual earnings suggested three groups of self-employed people:
 - those for whom earnings represent a secondary source
 - those for whom self-employed earnings represent the main source, but provide a low wage
 - those earning similar amounts as the average employee, and, in some cases, higher amounts.
- at the level of household income, average gross household income where the head was self-employed, in 1995, was slightly less than that of a household with an employee head.
- the pattern of sources of income suggests that households with a self-employed head are, on average, slightly more secure financially than those headed by an employee.

Living standards of self-employed people and households

- average household expenditures of households with a self-employed head are greater than the expenditures of households with an employed head, although average household incomes are lower.
- households in the lowest 20 per cent band of income distribution, whether headed by a self-employed person or an employee, are likely to spend an equal proportion of their income on necessities; but households in higher income bands (except the very highest) are likely to spend less of their income on necessities if they are headed by a self-employed person rather than an employee.
- self-employed men and women are more likely than employees to live in owner-occupied accommodation.

Chapter Six: The organisation of business and personal finances

Regulation and reporting of income

- there is no definite information about the numbers of self-employed people who use the services of an accountant. This may be about one half. In any case there is probably a rather low level of professional advice available about National Insurance matters from accountants.
- some self-employed people receive information and advice about NICs from trade or professional associations, but for many, the main or only source of information is likely to be the Contributions Agency itself.

Managing business and personal income

- little is known about the organisation of earnings from self-employment within personal budgeting strategies, or whether Class 2 NICs are conceptualised as business or personal expenditure.
- although the proportion of self-employed people belonging to personal pension schemes is gradually increasing, large numbers are currently making no arrangements.

Debt

- self-employment, by itself, does not increase the risk of problem debt. However, instability or fluctuation in income is a predisposing factor, and business failure seems to be an increasing trigger for mortgage arrears.
- strategies for managing debt may involve cutting back on social protection, or seeking additional earnings in forms of work that may count as self-employment.

Chapter Seven: Attitudes and understanding of personal financial responsibilities

Comprehension and understanding

- some self-employed people may meet problems in recognising that they are 'workers', while others may not cast themselves on the correct side of the employee/self-employed

divide. Ambiguities and uncertainties may concentrate among people in transitional situations, homeworkers, labour-only subcontractors, women and the lowest paid.

- some self-employed people may not understand the National Insurance scheme, or what is required of them.

The 'irregular economy'; evasion and fraud

- in general, self-employed people have greater opportunity to evade state financial regulatory control than people working as employees.
- studies of evasion deal mostly with evasion of income tax, but we do not know whether National Insurance is perceived as a tax.
- in terms of benefit fraud, some people with undeclared earnings do derive some income from self-employment such as petty trading.

Rewards for compliance

- there is little information about self-employed people's perceptions of the benefits of maintaining a National Insurance contributions record.
- social attitudes studies suggest that there is not wide-scale attitudinal resistance among self-employed people to the idea of making regular contributions to state welfare.
- basic state retirement pension makes an important contribution towards maintaining living standards of the current generation of pensioners who have had a history of self-employment.
- there appears to be low take-up of income-related benefits among self-employed people, as well as sickness and incapacity benefit.

There is an overall problem in interpreting literature about attitudes and understanding of personal financial responsibilities, in that so little is known about understanding and conceptualisation of Class 2 contributions.

Chapter Eight: Discussion

- it seems likely that reasons for non-registration include failure to recognise liability, problems in achieving registration, and, for some people, disinclination.
- reasons for falling into arrears with Class 2 contributions probably include problems of managing payments from self-employed incomes, problems of prioritising resources for people on low incomes, and, among some people, disinclination to pay.
- there are large gaps in our knowledge about perceptions, understanding and conceptualisation about National Insurance.
- current national data sets might be interrogated in more useful ways for the Contributions Agency.
- more appropriate questions for self-employed people might be inserted into the Customer Satisfaction Surveys.
- it might be useful to attempt to develop statistical estimates of the self-employed customer base, and the level of compliance.

SELF-EMPLOYED PEOPLE: A LITERATURE REVIEW FOR THE CONTRIBUTIONS AGENCY

INTRODUCTION

People over 16 years and under pension age who are working and earning must generally pay National Insurance contributions, unless they are exempt on grounds of low earnings. The contributions paid help people to qualify for contributory insurance benefits, when they have need of these. This has applied to self-employed people as well as employees since the introduction of the post-war Beveridge scheme.

Prior to the Beveridge scheme, self-employed people had not been incorporated into compulsory social insurance schemes, probably because they were thought of as wealthy people, or, at least, able to make private provision (Forde, 1979). Beveridge had a clear understanding, however, that by the 1930s 'many people working on their own account are poorer and more in need of State insurance than the employed' (Beveridge, 1942, p6). He was in no doubt that a comprehensive basic insurance scheme should include self-employed people (Brown, 1992). People often moved between differently organised forms of work throughout a working life, or at any one time might combine self-employed work with work for an employer, and Beveridge advocated a single comprehensive insurance scheme in which both employees and self-employed people participated, but on slightly different terms. Payments of a different 'class' of contribution would lead to a different range of entitlements, the most important of which was the exclusion of self-employed people from unemployment benefit.

This basic structure of distinction between employed earners and self-employed people has persisted, for purposes both of contributions and entitlements, although the basis on which contributions have been payable has varied over the years. Brown (1992) gives a full account of the development of the current position of self-employed people from the original post-war plan, including the introduction of earnings-related contributions in 1975.

Under current arrangements, self-employed people are normally liable for Class 2 contributions at a flat rate of £6.05 (1996-97) per week. Class 2 contributions are paid to the Contributions Agency by direct debit every month or in response to quarterly bills, both in arrears, and customers may choose which payment method they prefer. Class 2 contributions count towards retirement pension, incapacity benefit, widow's benefit and maternity allowance.

People with low earnings from self-employment do not have to pay Class 2 contributions and may be granted a Certificate of Exception. Currently, the level of net earnings below which self-employed people may apply for exception is £3,430 per year. Such people may elect to pay voluntary Class 3 contributions, set at £5.95 per week, to count towards retirement pension or widow's benefit.

In addition to Class 2 contributions some self-employed people are required to pay earnings-related Class 4 contributions on a band of income within specified thresholds. Currently, Class 4 contributions are payable at six per cent of profit between £6,860 and £23,660 for the year 1996-97. These Class 4 contributions are payable to the Inland Revenue along with income tax. They are not related directly to personal entitlement to benefits, being rather a means of collecting earnings-related contributions from higher-earning, self-employed people.

There is thought to be considerable under-collection of appropriate National Insurance contributions from self-employed people (NAO, 1991) and this attracts attention in the media (*The Guardian*, 1990) and among academics (Skinner and Robson, 1992). There are no published official estimates of lost revenue. Estimates prepared by DSS for Brown (correspondence reported in Brown, 1994) suggested that in 1987-88 there were nearly 900,000 self-employed people not paying National Insurance contributions and not in touch with the Department. Brown herself (1994), using numbers of self-employed people in 1990 as reported in *Social Trends*, 1993, and numbers of National Insurance contributors, as reported in *Social Security Statistics*, 1992, estimated that there were 856,000 self-employed non-contributors.

The Department of Social Security recognises two kinds of under-collection:

- non-registration, whereby self-employed people do not appear on the Contributions Agency register of contributors, and
- debt, whereby registered self-employed contributors have missing payments, or build up arrears.

There are various reasons for concern. If self-employed people are not making the contributions due from them, there is a shortfall in the monies coming into the National Insurance Fund, requiring increases in the balance necessary from the Exchequer to meet the costs of benefits payable, and administration. Those people who are not making contributions due are technically breaking the law. What might seem to be to their short-term financial advantage, in comparison with their fellow citizens who comply with requirements, may actually be to their eventual disadvantage. Without an appropriate contributions record, they will not have entitlement to contributory benefits that they and/or their dependants may need in the future. Should they then claim income-related benefits, this draws on monies from the Exchequer, rather than the National Insurance Fund.

The Contributions Agency is committed to increasing compliance with the law related to National Insurance contributions. One of the 1996/97 targets set for the Agency by the Secretary of State is to actively identify 40,000 persons with Class 2 liability who have an immediate requirement to pay contributions. The Agency's field offices already undertake a number of initiatives in their locality to identify self-employed people with a contributions liability, including liaison with the Inland Revenue, and education and promotional work with groups of self-employed people and their advisors. In order to prevent arrears and reduce debt, the Agency promotes direct debit payments, and has recently set up a specialised Debt Collection Unit to contact people on the quarterly billing system who have missing payments, and negotiate payments or instalments to reduce arrears.

There are likely to be a number of factors influencing the under-collection of Class 2 contributions. At the structural level, the overall design of the contributions scheme itself will have effect, including the levels of payments due, the availability and level of benefit payable by

return, and the general relationships between this scheme and other systems of financial liability and support. At the administrative level, there will be important influences such as the Contributions Agency procedures and practices, skills and efficiency of staff, design and distribution of information, and resources available for dealing with self-employed people. At the level of the client/customer, their beliefs, attitudes and behaviour will be critical components of the level of collection that can be achieved. A similar three-level model of influences proposed by van Oorschot (1991) to take forward our understanding of the non-take-up of benefits has proved useful (Corden, 1995), and it is likely that a full picture of factors contributing to under-collection of contributions will require a similar, multi-level approach.

At this stage, the Department has chosen to focus initial attention on the client level, and has commissioned a literature review of the characteristics of self-employed people. By looking at what is already known about self-employed people, including their attitudes to the National Insurance scheme and their experience of administration, it may be possible to gain useful insights into whether, and the extent to which:

- some people do not sufficiently understand their obligation
- some people encounter barriers to meeting their obligation, such as lack of incentive, or more pressing financial needs
- some people purposefully avoid meeting their obligation.

Until fairly recently, apart from a sociological literature on the culture of business and the attitudes and motivations of the 'entrepreneur', rather little attention has been paid to self-employment. A remarkable upsurge in self-employment during the 1980s, when the number of people recorded as self-employed rose by 95 per cent, focused greater attention on this group. It was realised that lack of knowledge about self-employment and marginalisation of self-employed people within social security policy-making had left self-employed workers in what might be called a 'policy vacuum' (Brown, 1992, 1994). Since then, research on self-employed incomes (Meager *et al.*, 1994), income-related benefits and self-employed people (Boden and Corden, 1994; Eardley and Corden, 1996a, 1996b; Bryson and Marsh, 1996) and self-employed parents' experience of the Child Support Agency (Boden and Corden, 1996) have started to fill some of the gaps in our knowledge. There is as yet, however, only a small literature directly

concerned with social security policy and outcomes for self-employed people. Within this body of literature and research, it is hard to find anything specifically addressing the participation of self-employed people in the National Insurance scheme.

The researchers have thus gone to a wider range of literature and knowledge to review what is known about the characteristics of self-employed people that might throw light on reasons for under-collection of Class 2 contributions. We have sought social and demographic information from household surveys and census data, and quantitative information about self-employed occupations and activities from labour market surveys and studies of work. We have looked at the quantitative and qualitative information available about the organisation of self-employed work, and the incomes derived from such work. We have consulted selectively literature concerned with income tax, VAT, private pensions, savings, debt and the informal economy. Some of these areas have provided relatively little material that seems directly relevant to the Contributions Agency's interest, and we point to areas in which there appears to be scope for further empirical work.

The review is organised in the following way. Chapter One considers what self-employment is in the context of National Insurance contributions, and explains that this is far from straightforward. Ambiguities and confusions that may arise seem likely to affect some clients' understanding of their formal situation with regard to National Insurance. On the other side of the same coin, the Contributions Agency faces problems in estimating and projecting the population liable to pay Class 2 contributions, and hence in measuring the apparent gaps in the Register and shortfall in revenue. Chapter Two describes the main demographic characteristics of self-employed people in terms of the growth and size of that population, the age, sex and family status of its members, and personal characteristics such as health and ethnicity. Attention is paid to the geographical distribution of self-employment, and the flows into and out of self-employment. Chapter Three is concerned with the kind of work that self-employed people do, in terms of occupation and industry, hours worked and levels of qualifications. Chapter Four describes the ways in which self-employed work is organised.

Chapter Five reviews the incomes of self-employed people, describing some of the problems of measurement, and going on to discuss the distribution of income, and some aspects of personal living standards.

Chapter Six asks how self-employed people organise their business and personal finances, and includes information about people who get into problem debt. Chapter Seven draws on literature about compliance and non-compliance with statutory regulation among self-employed people, most of which is concerned with taxation and social security benefits. In the final chapter, the authors reflect on the material presented, and how far it provides answers to questions about why some people do not register with the Contributions Agency, and why some fail to keep up payments. The authors identify some of the main gaps in relevant research and literature.

CHAPTER ONE

DEFINING SELF-EMPLOYMENT

The Contributions Agency has to arrange collection of contributions from individuals using legislative definitions of who is to be treated as an employee and who is self-employed. The legal constructs here are problematic, however, and many ambiguities and uncertainties arise. In addition, the conventions adopted for National Insurance administration do not always correspond with people's own perceptions of their status or the way in which they work, and this may affect their response to formal requirements. Interaction between the Agency and its clients becomes inevitably more complicated. An additional tier of complexity associated with the definition of employment status is the Agency's need to monitor its activities, using statistical analyses and comparisons with other relevant data sets. Definitions used by the Agency in order to deal directly with individual clients are often different from definitions and categorisations used for analyses of census data, national household surveys, labour force data, social attitudes surveys or studies of business organisation.

This chapter discusses different concepts of self-employment, and their relevance to the policy context at issue here. The first section discusses legal definitions; the second, the sociological approach; and the third, categorisations for statistical analysis.

Legal definitions

Legislative definitions of self-employment have origins in the regulatory categorisations imposed in the development of taxation of income (Boden, 1996), and have been further developed in the regulation of mutuality of obligation between employers and employees in employment law. People may not choose whether what they do is to be regarded as self-employment. It is worth remembering that the self-employed form a 'defined group' only in terms of externally imposed regulation, and there is no single inherent characteristic that is common to self-employed people. People with more than one job may be, of course, both an employee and self-employed.

The principal legislation governing the National Insurance scheme is the consolidated Social Security Contributions and Benefits Act 1992. This replicates the definition of self-employed

people used in the earlier Social Security Act 1975, in which the 'four-class' system of contributions was enacted. Thus, self-employed people are defined as those who are employed 'otherwise than in employed earner's employment' (s.2 (1) (b)). This somewhat negative definition is further defined by reference to the contract of service, a legal construct used in employment law. The 1978 Employment Protection (Consolidation) Act defines an employee as one working under a 'contract of service' whereas self-employed people have 'contracts for services' or 'contracts of their own kind'. The contract of service itself is defined in common law however, rather than statute law.

Although tax law is highly reliant on distinctions between employees and self-employed people, tax legislation does not define self-employment, and the Inland Revenue thus also relies on common law. Operational definitions distinguishing employees and self-employed people for purposes of taxation, social security and employment protection have been worked out by courts and tribunals on a case by case basis, as required (Leighton, 1983; Casey and Creigh, 1988). In terms of employment rights, protection under health and safety regulations, entitlements to social security benefits, and liability for National Insurance contributions (NICS), taxation and, more recently, child support liability, decisions made about employment status can be critical. Most of the statutory employment rights accorded to workers currently depend on the common law contract of service and are thus limited to employees (Hepple, 1986).

Statutory definitions couched in negative terms and reliance on common law make room for interpretation and conflict. Over the years courts and tribunals have had to make decisions about numerous complaints and appeals brought to them which involve determination of employment status (Leighton, 1983). Despite numerous adjudications no clear, consistent definition has emerged. Rather, a number of tests have evolved in order to assess various aspects of the relationships between the parties to the contract which may be considered important for purposes of employment law (Luckhaus, 1991; McCarthy, 1993). The 'personal service test' has been used to indicate whether the worker does the job him/herself or can provide substitute labour. This test is unhelpful in subcontracting arrangements, however. The 'control test' has been used to assess the amount of control exercised by the party paying for the work, including who decides the time spent on the performance of the work, and where responsibility lies for training or supervision.

The 'integration test' tried to assess whether the worker was integral to the organisation. The 'economic reality test' looked at how far people seemed to be 'in business on their own account', for example which party had responsibility for providing equipment, pricing the work, seeking profits and taking the risks, and whether the work was done continuously for one individual or organisation, or two or more. Historically, there was more emphasis on the 'control' aspects in the contract but this has tended to give way to an approach that looks more broadly across a range of factors, to see how the general balance falls (Leighton, 1983; McCarthy, 1993). Lately, Luckhaus suggests, the economic reality tests have seemed to carry greatest weight.

The development of case law in this way has led to many inconsistencies in decisions. Hepple (1986) reviews some of the well-known cases in labour law where courts have made contradictory decisions about individuals in similar situations, and Leighton (1986) describes current case law as 'incoherent and inconsistent'. The problems are further reviewed by Ewing (1992) and, from the perspective of Scots law, by Davidson (1992).

Although tax and social security law are separate areas of legislation, the Inland Revenue and the Department of Social Security use the same body of general case law to determine employment status. Deciding factors now include aspects such as entitlement to profits, the degree of risk taken by the individual, the number of customers the person has, and the provision of business equipment as well as whether the commercial contract is one for service (employees) or for services (self-employed). Under company law, owner/directors of small limited companies are legally employees of their company, and dealt with as employees. It is the policy of the Inland Revenue and the Department of Social Security that their decisions on employment status should be consistent, and the general rule is that once a ruling has been made by one body, this is accepted for both purposes. Decisions made by the Inland Revenue and Department of Social Security are not always consistent with decisions made for purposes of employment law, however. A small study by Leighton (1984) showed that potential employers of homeworkers received conflicting advice on how those workers should be categorised, from the Department of Employment, the Department of Social Security and the Inland Revenue, and, in some cases, from different officials within the same organisation. The Inland Revenue and the Department of Social

Security reviewed their policies in this area in 1994, with some suggestions for improvement in consistency (Kiseley and Hume, 1994).

However, there are some areas where the two departments depart from general case law, and may use different criteria. The Social Security Act authorises the Secretary of State to issue regulations that particular groups of workers should be treated as Class 1 or Class 2 contributors, and this may mean they are treated differently under tax arrangements (Forde, 1979). As a result of The Social Security (Categorisation of Earners) Regulations, 1978 No. 1689 and The Social Security (Computations of Earnings) Regulations, 1978 No. 1698, office and telephone apparatus cleaners are always treated as employees for contributions purposes, but examination invigilators are self-employed. Many agency workers and ministers of religion are dealt with as employees. Skinner and Robson (1992) suggest that having categorisation regulations which apparently override basic tests of fact is a major difference from income tax treatment. Exceptions here include some divers and diving supervisors, who are assessable in income tax law under Schedule D (income from self-employment) according to section 314, Income and Corporation Taxes Act 1988 despite the fact that they are employed, and some people who provide services through employment agencies, who are taxed under Schedule E (employed earnings). Apart from this small number of specific occupations which are individually categorised by special rules, no concise definitions have emerged to clarify the characteristics of self-employment.

For many people, decisions about employment status are clear-cut for purposes of taxation and social security. As we might expect, however, some confusions and ambiguities remain. 'There is a grey area on the border where the issues lend themselves to sophisticated argument and are not easy to resolve' (Kiseley and Hume, 1994, appendix 1, p2).

A recent example of the way in which confusion and ambiguity about employment status causes problems in administering the National Insurance scheme was the need for new Regulations to address the situation of people such as certain freelance workers in broadcasting, film and video industries who had paid Class 1 contributions believing that these would count towards SERPS. They subsequently found that they were self-employed. The Social Security (Additional Pension) (Contributions Paid in Error) Regulations 1996 enabled refunds of the employer's contribution

to the Class 1 Contributions to be paid, but enabled the workers involved to count their incorrect contributions towards SERPS or a personal pension, rather than having to take a refund (DSS, 1995a, 1996).

Some authors have argued that the failure of the law to provide proper operational definitions of the characteristics of self-employment, and the general incoherence and inconsistencies that result, suggest that the distinction should be abandoned. This argument is usually put forward in the context of employment rights, and the exclusion of many marginal workers from protection, if they are deemed to be outside a contract of service (Leighton, 1983, 1986; Hepple, 1986). In the context of this study, the argument helps our understanding of the possible effects of structural influences on under-collection of Class 2 contributions. In a scheme which depends on a basic distinction between employees and self-employed people, which is a categorisation resting on ambiguous or uncertain concepts, some problems in implementation are likely to remain. Evidence of confusions and misunderstandings about employment status among workers is presented later in Chapter Seven.

A sociological approach

Sociological and economic analyses of self-employment have, it is argued, been limited. Nevertheless, much of the theoretical development and research on self-employment that has been conducted comes from a sociological perspective. It is therefore appropriate to look at this approach to categorisation and distinction of self-employed people.

The traditional sociological approach, within theoretical frameworks of industrial production and Marxist sociological theories on class (Curran, 1990; Bögenhold and Stabler, 1991) was to see self-employment as an anachronistic form of work, which might be expected to decline. Self-employed people, who owned their own means of production and employed little or no wage labour, were seen as belonging to a group of *petit bourgeois* workers, including craftspeople, independent professionals and small business proprietors. This group was distinguished from waged workers by their ownership and control of production, and their autonomy. These distinct characteristics were reflected in the allocation of small business owners and own account workers to a separate class location (Goldthorpe, 1980; Wright, 1985). The sociological distinction of the

petit bourgeois stresses the uncertainties and vulnerability of self-employment, but emphasises the freedom and autonomy it bestows (Dale, 1991).

The *petit bourgeois* grouping is problematic, however. Those who are so categorised do not clearly share interests and ideologies (Bechhofer and Elliott, 1981). Some do describe their motivations in becoming self-employed in terms of 'independence', 'choice', 'challenge' and 'working for oneself' (Bevan *et al.*, 1989; Goffee and Scase, 1985). However, it is hard to know whether these represent people's real aspirations or just reproduce the dominant stereotypes of self-employment, and rationalise current work situations (Hakim, 1988). The realities of self-employment are often far from those of the autonomous small trader, and more pragmatic attitudes are expressed by some self-employed people, who describe the need to earn a living, or the lack of other opportunities as reasons for self-employment (Bechhofer and Elliott, 1978; Scase and Goffee, 1980; Lee, 1985). Nevertheless, the 'ideology' of self-employment and the 'enterprise culture' is strongly established, and the 'philosophy of self-employment' (Hakim, 1988) remains firmly espoused by many new entrants to self-employment.

One strand in analysis of the *petit bourgeois* has been to look for the links between this class and wider social and economic structures leading to further attempts to categorise and distinguish self-employed people. Wright (1985) suggests distinguishing 'small employers', who are defined as having between two to nine employees, from *petit bourgeoisie* (sic) who have one or none. Scase and Goffee (1982) develop the concept of the 'entrepreneurial middle class'. They argue for a four-fold typology, with distinctions based on relative mix of capital utilised and labour employed, thus: the self-employed, the small employers, owner/controllers and owner/directors. Curran and Burrows (1987) identify the sociology of the entrepreneur as one of the main themes within the social analysis of small businesses, and Curran (1990) points to the value of this kind of analysis in exploring the organisational analysis of the small enterprise, a topic which has not yet received much attention.

The nature of much of the recent increase in self-employment suggests that the distinction of the *petit bourgeois* is no longer tenable. Recent decades have shown growth in forms of work which are legally and contractually defined as self-employment, but which are hard to fit into the *petit*

bourgeois/small business framework. This has been called 'quasi-self-employment' or sometimes 'nominal self-employment' and includes labour-only subcontracting, franchising, working as agents or freelancers, and forms of outworking and homeworking, (Dale, 1986; Eardley and Corden, 1996a). (These various forms of self-employment are described later in Chapter Four.) In terms of individual control, autonomy, and the opportunities for financial advancement, the actual work situations of people in this kind of self-employment may be much more like those of employees.

Issues of gender and ethnicity have only recently emerged in the social analysis of small business and self-employment. The assumption that small-scale enterprise was the activity of 'economic man' went unchallenged (Curran and Burrows, 1987, p171). Recent studies, however, have emphasised the major contribution to the work of self-employed men of their domestic partners (Scase and Goffee, 1980, 1982; Eardley and Corden, 1996a). Much of such work may remain invisible or only partially reflected within formal regulatory schemes - essential work such as administrative and clerical tasks, cleaning and repairing equipment, arranging orders and appointments, and enabling telephone communications. The formal employment status of women who contribute in this way is an interesting issue in taxation and social security policy. As we shall see, however, there is very little systematic data about the way domestic partners share the work of self-employment.

Women who are themselves owners and proprietors of small enterprises have, until recently, received relatively little attention within the sociological perspective. Goffee and Scase (1987) comment on the apparently limited feminist interest in female business proprietorship so far. More recently, Green and Cohen (1995) point to a growing literature on women entrepreneurs and highlight the importance of feminist perspectives. At the other end of the 'spectrum' of self-employment, the situation and experience of low-paid women homeworkers has been a focus of attention. Later in the chapter we see that confusion and ambiguity about employment status among homeworkers is widespread.

There is a small sociological literature on ethnic minority participation in small-scale enterprise, (see Ward, 1987; Ward and Jenkins, 1984; Curran and Burrows, 1987). Jenkins (1984) offers

three models: economic opportunities in ethnic niche markets; cultural predispositions of ethnic minority group members; and survival strategies in a racist society.

There is a link to the economic literature through the concept of the 'small firm'. The industrial economist is interested in new firms to the extent that they influence the pricing and outputs of firms already in that market. Labour economists view the start of small firms as an outcome associated with various personal 'entrepreneurial' characteristics such as personality, human capital and ethnic origin. Personality measures, in these terms, include attitudinal scores about desire to work independently, family influences and propensity to take risks. Human capital is measured in terms of education and work experience. Storey (1994) explains the different theoretical backgrounds of industrial and labour market economists in discussing the birth and death of small firms. There are useful perspectives on aspects of some kinds of self-employment within the economic literature, drawn out in later chapters.

This section has considered some of the main themes in the emerging sociological analysis of self-employment and small business, and provided references for those who wish to pursue further the categorisations and definitions used within sociological theory and research. In terms of the question, 'who are the self-employed?', the literature we review in this section provides answers within a particular discourse. Here, self-employed people have been considered as 'atypical workers' who occupy a specific class location, as the '*petit bourgeois*' section of society. There is a search for the apparent characteristics of the 'entrepreneur' and more recently, the 'ethnic entrepreneur' or the 'female entrepreneur'. Some people are grouped together as 'small business owners' and, at the other end of the spectrum, some are identified as 'disguised wage-labourers'. Such categorisations overlap; they are not legal terms and do not match the administrative definitions used by the Contributions Agency. However, these categorisations are important as they underpin much of the theoretical development and research into self-employment. They also both contribute to and reflect the self-perceptions and identities of self-employed people, which may affect compliance with National Insurance liabilities.

Categorisations for statistical analysis

Surveys and statistical analyses are important sources of information about characteristics, trends and developments among self-employed people. However, the definitions used in designing research instruments and analyses of data do not always reflect either legal and technical definitions, sociological categorisations or people's self-perceptions (Dale, 1991).

The main source of national employment data, the Labour Force Survey (LFS)¹, bases its classification of respondents primarily on self-definition and then by reference to tax or national insurance data if the respondent is in doubt. Sub-contracted workers are thus included within the ranks of the self-employed, but a problem remains in interpreting data about company directors. There are no direct questions to identify company directors. Those people who give their occupation as 'company director' are reclassified as employees. Some of those who describe their occupations in terms of activity such as 'computer programmer' or 'film-maker', for example, may remain among the 'self-employed'. Some idea of the difference this issue can make to statistics of the self-employed can be found from a checking exercise carried out on the 1981 Census (Hakim, 1988). This resulted in a reclassification of some 300,000 company directors who had assessed themselves as self-employed, reducing the Census figures for self-employment by 13 per cent (OPCS, 1984). It is not known how many company directors correctly assess their legal status in either the Census or in the LFS. Another source of considerable uncertainty in the LFS is the ambiguous position of some temporary and casual workers, some of whom might conceivably be classed as self-employed.

It has been argued that the LFS overstates self-employment growth (Daly, 1991) and that this may be one of the reasons why LFS data have shown faster growth in self-employment than data from National Insurance or VAT records, but Daly finds no clear evidence. The additional advantages of using LFS data include quick publication and relative accessibility. However, Hakim (1988) argues that the problems of identification of employment status mean that survey statistics are best used only as a rough measure of change at the macro-level and provide a poor basis for explaining change. Moreover, routine labour market statistics provide a poor measure of entrepreneurial

¹ National data sets providing information about self-employed people are discussed in more detail in the following chapter.

activity, or the incidence of small enterprise. Transitions between unincorporated and incorporated status can suggest 'disappearance' of some enterprises which have actually grown successfully, and become incorporated businesses with workers reappearing in the statistics as employees.

Household surveys, such as the Family Expenditure Survey (FES) recognise that it is insufficient just to ask people whether they are employed or self-employed, and instructions to the interviewer allow employment status to emerge, according to subsequent answers. There are early instructions to interviewers to treat company directors as employees, and other questions later in the schedule to reroute those who identify themselves incorrectly. People who are earning small amounts from occasional work as babysitters or catalogue mail order agents are classified in the FES as 'unoccupied' and within those who are economically inactive, whereas in the General Household Survey (GHS) mail order agents are included in the self-employed category. New questions about employment status and self-employed income have been tested recently, and included in the FES and Family Resources Survey (FRS) from April 1996, in order to collect data of a higher standard (Martin *et al.*, 1996).

Discrepancies between datasets, or reclassifications, can have important implications for the measure of self-employment. When, in 1982, self-employed people with no other employment and small earnings of £3.50 per week or less were reclassified for FES as unoccupied, the self-employment rate estimated from this source fell sharply from over 11 per cent in 1981 to eight per cent in 1982 (Hakim, 1989a).

Homeworking is another area in which survey data are inconsistent. In the LFS those homeworkers who define themselves as self-employed are classified as such, although it is recognised that a number of them would legally be considered employees (Dale, 1991). In the FES, all 'outworkers', that is, people working at home for somebody else, are classified as employees. However, detailed interviews with homeworkers, for the Department of Employment (Felstead and Jewson, 1996) revealed that half regarded themselves as employees, and 31 per cent as self-employed. Forty-two per cent believed that their work supplier regarded them as self-employed.

More detailed accounts of the discrepancies in definitions of self-employment in the main employment and household surveys can be read elsewhere (Hakim, 1989a; Dale, 1991; Daly, 1991; Eardley and Corden, 1996a, 1996b). The point is to emphasise the difficulty of discussing the representativeness of survey data. It is the analyst's definitions of self-employment which determine who is included, especially at lower earnings levels, and the rules established may be different from sets of rules devised for other purposes. This has already been recognised as one of the problems of using household income survey data for estimates of take-up of social security benefits (Eardley and Corden, 1996b). There would be similar problems in trying to measure under-collection of Class 2 NICs. However, it might be useful for the Contributions Agency to start to develop themselves statistical estimations of the customer base, and the level of compliance. The technical development of the take-up formulae used by DSS might be informative in this respect (see, for example, DSS 1995b).

The survey categorisations discussed so far are classifications based on occupational status. Surveys of social attitudes are often analysed within a framework of class structure, in which characteristics of occupational activity, labour relationships and source of income are combined to identify social groups (as discussed in the previous section). Within the 'middle class' in some such groupings, self-employed people are to be found as 'entrepreneurs' or 'professionals', whereas some analyses present data derived from the '*petit bourgeois*'. For example, data from the British Social Attitudes surveys, which have been conducted since 1983, have recently been presented within a class analysis in which self-employed people appear within the '*petty* (sic) *bourgeoisie*' along with five other social classes. Findings from this analysis are useful (and are discussed in later chapters) but the analytic grouping of the *petty bourgeoisie* may not match legal or technical distinctions, or groups from other survey analyses (Dale, 1991).

This chapter has addressed the question of what self-employment is, in the context of National Insurance contributions, and has looked at legal definitions, categorisations within the sociological tradition, and survey definitions. The legal definition of self-employment is couched in negative and circular phraseology, linked to the common law definition of the contract of service, and as such, leaves room for much ambiguity and uncertainty. A number of specific categorisations have been laid in regulations, to enable administrative distinctions to be made at an individual level, but

these may not always reflect the real world of work, or perceptions of workers and suppliers of work. The distinction between employees and self-employed people which permeates labour law, tax and social security legislation attracts criticism for a variety of reasons, including these conceptual problems. Without any structural change it thus seems likely that some problems in collecting Class 2 NICs will remain, despite efforts to improve the situation at the administrative and client levels.

Much of what we know about self-employed people comes from a sociological perspective, but there has been a concentration of interest here in those identified as 'entrepreneurs' and the aspirations and activities of people engaged in small business activities. There is a substantial sociological and employment literature underpinning a popular representation of self-employment as activity characterised by enterprise, autonomy, choice and challenge, but this image of self-employment is actually far from the reality of many forms of work.

A further tier of complexity in deciding what self-employment is comes from the different approaches taken in the main labour and household surveys, which provide contextual information about the characteristics of self-employed people. In the operational context this is relevant to the estimate of the numbers of people who are not complying with Class 2 NICs, the proportion of revenue forgone and the scope for enlarging the Register or increasing collection.

For readers of this review, it is essential to remember that the variety of definitions and categorisations of self-employment used within the various literatures means that in what follows, those people discussed as self-employed will differ according to the source of the information.

CHAPTER TWO

THE DEMOGRAPHIC CHARACTERISTICS OF SELF-EMPLOYED PEOPLE

There are no specific substantial surveys of the self-employed in the same way that the New Earnings Survey gathers information about employees, despite the growth in self-employment over the past decades. A variety of national data sets do, however, provide varying amounts of information on self-employment and National Insurance. The large national surveys such as the General Household Survey (GHS), the Family Expenditure Survey (FES), the Family Resources Survey (FRS), the Labour Force Survey (LFS) and the British Household Panel Survey (BHPS) all provide information on the demographic characteristics of self-employed people, such as the size of the self-employed population, sex, age and geographical distribution. Ethnic background of self-employed people is not available in the FES, and the sample of the self-employed is relatively small in the BHPS. This chapter uses published information from these surveys, either from the survey reports themselves or from other work reporting secondary analyses of the data from the surveys.

Daly (1991) concludes that for almost all purposes the LFS is the best source of self-employment data, and much of the work discussed in this chapter uses information from the LFS. The reservations mentioned by Hakim (1988) and discussed in Chapter One should be borne in mind. However, until the definition of self-employment is agreed, and uniformity of classification is adopted by all surveys, the sample size and the frequent updates make the LFS a particularly valuable source of information about self-employment. Possibly one of the most interesting analyses presented for the Contributions Agency is a regional breakdown of the level of male, female and total self-employment, and of the prevalence of self-employment in different regions.

Sly (1994) compared economic activity as recorded in the LFS and the 1991 Census and concluded that there was little difference between them. The LFS in Spring 1991 recorded 3,316,000 self-employed workers which compares with 3,078,000 recorded in the Census taken in April 1991. The figures for male self-employment were similarly close: 2,511,000 self-employed men in the LFS and 2,374,000 in the Census. There was a greater discrepancy for

female self-employment: 805,000 in the LFS and 705,000 in the Census, a 12 per cent difference compared with a five per cent difference for men. The same problems of self-categorisation exist in the Census and the LFS, but this exercise suggests that the sample survey method of the LFS does not introduce too much discrepancy when compared with the complete count of the Census (although the similarity of data does not indicate the validity of data, of course).

Despite the growth in self-employment, it does not appear as a chart or table in the most recent *Social Trends*, although there is an indication that the proportion of overall household income from self-employment has risen from nine to ten per cent between 1971 and 1994, with a fall to eight per cent in 1981.

This chapter brings together the most recent data from the above national surveys, with contextual information from other sources. The previous chapter drew attention to the important proviso when considering demographic characteristics of the self-employed that different data sets define the group in slightly different ways.

The first section of the chapter is concerned with the recent growth in self-employment, and the size of the current male and female populations of self-employed people. The second section presents findings about the age, family status, health and ethnicity of people in self-employment, and, relatedly, the propensity for self-employment in different population groups. The third section looks at the geographical distribution of self-employed people, and the final section considers flows into and out of self-employment.

The growth and size of the self-employed population

The most recently available figures (*Labour Force Survey Quarterly Bulletin*, Number 16, June 1996) indicate that there were 3.219 million self-employed people in Great Britain in the winter of 1995/96. Between the early 1980s and 1990, self-employment increased from 2.201 million in 1981 to a peak of 3.472 million in 1990 (Table 2.1). The proportion of people who were self-employed in their main job, amongst all those in paid work, rose from 9.3 per cent in 1981 to 13.5 per cent in 1990. The overall picture is that the most rapid rises in aggregate self-employment occurred in the early 1980s. The increase was halted in the recession of 1990-92 (reaching a low

point of 3.05 million people in the winter of 1992) but then resumed an upward trend. Compared with the winter of 1994/95, numbers of self-employed people in 1996 have dropped slightly, by 2.1 per cent. However, as Eardley and Corden (1996a) describe, year-to-year changes tend to be prone to sizeable fluctuations, partly due to sampling errors. The proportions of all those in employment who are self-employed have fluctuated around 13 per cent since 1990.

Table 2.1: The rise in self-employment, Great Britain, 1981-96

	<i>Self-employed (thousands)</i>	<i>Self-employment rate¹ (%)</i>
1981 Spring	2201	9.3
1986 Spring	2727	11.6
1990 Spring	3472	13.5
1991 Spring	3318	13.2
1992 Spring	3131	12.8
1993 Spring	3103	12.7
1994 Spring	3208	13.1
1995 Spring	3260	12.8
1995/6 Winter	3219	12.5

¹ Self-employed in main job as percentage of all in paid work

Sources: Eardley and Corden (1996a) Table 2.1

Labour Force Survey Quarterly Bulletin, Number 16, June 1996.

The UK rate of growth in aggregate self-employment was the highest among countries in the European Union between 1979 and 1988 (Daly, 1991) and much attention has been paid to this. Eardley and Corden (1996a) review the explanations put forward for the upsurge in self-employment in Britain. At a macro-level, self-employment tends to increase at times of high unemployment (Curran, 1990) supporting the idea of a counter-cyclical response to recession, related to unemployment levels. Bögenhold and Staber (1991) analysed aggregate self-employment rates in eight major OECD countries from 1957-87, and found a strong positive correlation between unemployment and self-employment, for most countries. However, Meager *et al.* (1994) argue that there is unlikely to be a single macro-economic explanation of this kind, particularly because of the heterogeneity of the self-employed population.

It seems likely that there are a number of other contributory factors which interact with the economic cycle. These include the level and direction of structural change in the economy, such as the restructuring of industry away from manufacturing and towards services (Pollert, 1988). Shifts in employers' contractual arrangements towards more 'flexible' work arrangements through subcontracting, franchising and other forms of self-employment may also be important, although this argument is controversial (Pollert, 1991). Other influences that have been suggested as contributing to the UK trends include the promotion by government of an 'enterprise culture', but this has been criticised by, among others, Curran (1990) and Meager *et al.* (1994).

Men have always formed the majority of the self-employed; 2.421 million compared with 0.798 million women in the winter of 1995/6, that is 75 per cent and 25 per cent respectively (Table 2.2). During the 1980s, however, there was a greater percentage increase (77 per cent) in the numbers of women who were self-employed compared with men (44 per cent). The numbers in self-employment have fallen slightly by similar small amounts for both men and women since 1991.

Table 2.2: Numbers and growth in male and female self-employment, Great Britain, 1991-96

	<i>Thousands</i>				<i>Percentage increase</i>	
	1981	1991	1995	Winter 1995/6	1981-1991	1991-1995
Men	1745	2512	2463	2421	44	-2
Women	455	806	798	798	77	-1
All	2201	3318	3261	3219	51	-2

Sources: Eardley and Corden (1996a) Table 2.2

Labour Force Survey Quarterly Bulletin, Number 16, June 1996

Dex and McCulloch (1995) use LFS data to present a profile of changes in the self-employed population, by sex, by whether employment was full-time or part-time, and by whether the self-employed person employed others. Between 1986 and 1994 the proportion of men working as self-employed rose from 14.6 per cent to 16.9 per cent. The increase in women working as self-employed was not so great, from 6.6 to 6.8 per cent over the same period. Among both men and

women there was a fall in the proportion who employed others, from 5.6 to 4.4 per cent among men, and from 2.1 to 1.8 per cent among women. Most of the growth was in self-employment without employees, for both men and women. Table 2.3 shows that most male self-employment has been full-time, whereas female self-employment is divided evenly between full-time and part-time work. Women's full-time self-employment, unlike men's, has decreased slightly between 1986 and 1994.

Table 2.3: Numbers of self-employed people with and without employees, and who work full-time and part-time, Great Britain, 1994

	<i>Men</i>		<i>Women</i>	
	thousands	percentages	thousands	percentages
All	2281	100	732	100
With employees	597	26	194	27
Without employees	1684	74	538	73
Full-time	2052	90	361	49
Part-time	229	10	371	51

Source: Labour Force Survey, 1994, in Dex and McCulloch (1995)

Daly (1991), has drawn out a considerable amount of information on the growth of self-employment from the LFS throughout the 1980s. His brief conclusions (similar to those of Dex and McCulloch for later years) are that the growth has predominantly been among the single-handed self-employed. Only a small percentage of the growth has occurred among those with employees, although it might be expected that some of the new entrants would acquire employees. The greatest growth has been in the construction industry.

Personal characteristics of self-employed people

Age

Overall, the age profile of the self-employed is older than that of the working population according to Eardley and Corden (1996a). The Family Spending analysis of FES data (King, 1995) gives information about 626 households headed by a self-employed person, among a total sample of 6,853 (9.1 per cent). Households with a self-employed head were of similar size to

those headed by a full-time employee, but the average age of the head was five years older. Curran and Burrows (1989) in their analysis of GHS data showed that the most common ages for self-employment were between the early 30s and mid-40s. Later analyses using LFS data (Daly, 1991; Campbell and Daly, 1992) showed a similar age distribution pattern, which had changed little since 1981. Table 2.4 presents the information on the numbers of self-employed in each age group in 1991 from Campbell and Daly's (1992) article with the addition of the percentages of self-employed in each age group. Self-employment is less common than being an employee among people of all ages but particularly for those under 25 years. It is much more common, at 30 per cent of all those in employment, among those over state pension age.

Table 2.4: Self-employment at different ages, Great Britain, 1991

<i>Age in years</i>	<i>All self-employed</i>			<i>Men</i>			<i>Women</i>		
	thousands	percent of self-employed	percent of total employment	thousands	percent of self-employed	percent of total employment	thousands	percent of self-employed	percent of total employment
16-24	246	7.4	5.2	198	7.9	7.9	48	6.0	2.2
25-44	1,733	52.3	13.6	1,291	51.4	17.9	441	54.8	8.0
45-54	786	23.7	15.8	591	23.5	21.6	195	24.3	8.8
55-59	260	7.8	14.7	201	8.0	19.5	59	7.3	8.0
60-64	160	4.8	16.3	130	5.2	19.9	30	3.7	9.2
65+	131	4.0	30.4	100	4.0	32.3	31	3.9	20.1
All	3,316	100.0	13.0	2,511	100.0	17.4	805	100.0	7.2

Source: Campbell and Daly, 1992, Table 10

Curran and Burrows (1989) had suggested that the age distribution might be linked to an 'age launch window' - a time in an individual's life when the combination of ambition, experience, energy and access to capital make it possible to start in self-employment. There had also been suggestions that self-employed people might be more likely to continue working after retirement age than employees, because of their relative lack of access to pensions, greater job satisfaction or absence of retirement age determined by an employer. However, Daly's (1991) analysis of the

likelihood of entering self-employment by age throws further light on the age distribution. He shows that the largest proportion of new entrants to self-employment occurs in the age range 16-24 years. A high proportion of this age group also leave self-employment, resulting in a relatively low proportion in self-employment in this age group at any point in time. The higher proportions of self-employment at older ages are not due to higher numbers entering self-employment at these ages but to the cumulative effect of people remaining in self-employment. Similarly, the high number of new entrants over retirement age suggests a flow from employed work into self-employment. We return to the question of flows through self-employment later in the chapter. What is important is that a cross-sectional analysis of the age distribution of the self-employed does not give a full picture.

Dex and McCulloch (1995) give a recent analysis of the likelihood of self-employment for different age groups for men and women using data from the 1994 LFS. They show (in Table 2.5) that only 3.0 per cent of men aged 16-19 were self-employed in 1994, rising to 25.6 per cent of men in the five years prior to state pension age. Compared with Table 2.4, men aged 60-64 years appear to have a greater likelihood of self-employment in 1994 (25.6 per cent) than in 1991 (19.9 per cent). This may be a result of sampling variation in different years.

Table 2.5: The likelihood of self-employment with and without employees for different age groups, Great Britain, 1994

Age in years	Men			Women		
	all %	with employees %	without employees %	all %	with employees %	without employees %
16-19	3.0	(0.1)	2.9	(1.5)	-	(1.5)
20-29	10.6	(1.5)	9.1	3.3	(0.4)	2.8
30-39	17.3	4.5	12.8	8.6	(1.9)	6.6
40-49	20.4	6.7	13.7	8.5	2.5	5.9
50-59	22.7	6.3	16.4	8.2	2.6	5.7
60-64	25.6	6.2	19.4	-	-	-

Source: Dex and McCulloch (1995); data are for working age population (16-59/64); LFS Spring 1994 (weighted data)
() Based on small cell size

Family status

Turning to family status, self-employed workers, whether men or women, are more likely to be married or cohabiting than are employees. Table 2.6 shows that 72.1 per cent of self-employed men were married compared with 64.4 per cent of men in full-time permanent employment. Self-employed men with employees were even more likely to be married. The same pattern can also be seen for women in self-employment compared with female employees

Table 2.6: Marital status of self-employed men and women compared with that of employees, Great Britain, 1994

	<i>Full-time permanent employee</i>	<i>Part-time employee</i>	<i>Self-employed</i>		
			all	with employees	without employees
	%	%	%	%	%
<i>Men</i>					
Married	64.4	35.9	72.1	84.0	67.8
Living together	8.5	4.7	8.3	5.6	9.2
Single	22.6	54.7	14.3	6.4	17.1
Widowed	0.5	(0.6)	(0.4)	(0.3)	(0.4)
Divorced	2.8	3.3	3.7	2.3	4.3
Separated	1.2	(0.9)	1.2	(1.3)	1.2
Number of men (thousands)	9,843	829	2,273	596	1677
<i>Women</i>					
Married	50.3	73.8	74.4	81.5	72.0
Living together	12.2	4.3	7.0	(6.6)	7.2
Single	27.6	13.4	9.7	(5.0)	11.3
Widowed	1.4	1.8	(1.7)	(2.0)	(1.6)
Divorced	6.4	4.5	4.9	(3.2)	(5.5)
Separated	2.1	2.1	2.2	(1.8)	(2.4)
Number of women (thousands)	5,258	4,623	723	183	540

Source: Dex and McCulloch, (1995); LFS Spring 1994 (weighted data).

() Based on small cell sizes

According to recent figures for spring 1995 (*Labour Market Trends*, March 1996), the likelihood of being self-employed was greater for married or cohabiting men and women than for those in other marital circumstances. Five per cent of married or cohabiting women were self-employed compared with two per cent of non-married or cohabiting women. The corresponding figures for men were 16 per cent of married or cohabiting and eight per cent of those without a partner. Dex and McCulloch (1995) give more detail of the likelihood of self-employment amongst people of different marital status for the spring of 1994 (from the Labour Force Survey). Among men, single men are less likely to be self-employed than others, who may currently be married, cohabiting, divorced, widowed or separated. There is a slightly greater likelihood of self-employment among divorced men than among others in this latter group. Married and widowed women are the most likely to be self-employed. Official statistics are unlikely to give a full picture of women's self-employment, however. As we show in Chapter Four, women are often involved informally with their partners in small enterprises, although their contributions may not be formally recognised.

Households with a self-employed head contain, on average, 2.89 people including 0.80 children, compared with 2.74 people including 0.83 children in households with an employed head, among other non-retired households (FES 1994/5). Self-employment rates for women are generally higher among those with children, and this is also true for married women, looked at separately. One way of delivering information about social security matters to parents, especially women, is via the delivery of child benefit. The Contributions Agency may therefore be interested in the numbers of self-employed women with children of different ages, as shown in Table 2.7.

Table 2.7: Self-employed women and ages of children, Great Britain, winter 1995-96

	<i>Self-employed women</i>		<i>All women in employment</i>	<i>Self-employed as percentage of all employed women</i>
	thousands	%	%	%
Aged 16 and over	790	100	100	7
Aged 16-59 years	712	90	96	6
Women aged 16-59 years with dependent children under 16 years	329	42	34	8
Of which youngest child:				
0-4 years	113	14	13	8
5-10 years	125	16	12	9
11-15 years	92	12	10	8
Women aged 16-59 years without dependent children under 16 years	383	48	62	5

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

Campbell and Daly's (1992) analysis of LFS data showed that overall, self-employment rates among married men with dependent children are virtually the same as rates among those without. However, there are some differences within men's age groups, with substantially greater self-employment rates among married men with dependent children than among men without dependent children in the 25-34 years and 45-54 years age groups, no difference in the 35-44 years age group, but much lower rates among 16-24 year olds.

One issue of interest is the extent to which there are 'family connections' in self-employment. People with self-employed spouses are more likely to be self-employed themselves than those with spouses who are not self-employed (Curran and Burrows, 1989). Carter and Cannon (1988) also found that about three-quarters of self-employed people had some family connection with self-employment during their lifetime.

Health

Few previous analyses of the characteristics of self-employed people from large national data sets have concentrated on aspects of health and disability among self-employed people; small numbers

of people reporting health problems often do not permit detailed analysis. Analysis of the employment of disabled people has also tended to concentrate simply on whether they were working rather than whether they were employees or self-employed (Martin *et al.*, 1989). However, health is likely to be an issue of considerable interest to the Contributions Agency. People who face problems with their own health may be specially alert to the need for financial security in periods of sickness, and those whose earnings are reduced by ill-health, or by their responsibilities as carers of other household members, may have special regard to the need to ensure their security in retirement.

Eardley and Corden (1996a) report some evidence that disabled people in work were slightly more likely to be self-employed than the general working population, and a previous article by Daly (1991) showed that the rate of self-employment among people with health or disability problems was similar to that in the general population, but marginally higher. It also showed that there was little difference in their propensity to employ others or to work part-time. A study of self-employed people in six selected labour markets suggested that there was little difference in perceptions of physical and mental health between employed and self-employed respondents (Rubery *et al.*, 1993).

Campbell and Daly (1992) found that more than seven per cent of self-employed people said they had health problems or a disability which limited the type of work they could do. The 1994-95 GHS (Bennett *et al.*, 1996) shows that 12 per cent of all those in work report that they are suffering from a limiting long-standing illness. The proportion varies from nine per cent of men and women in work aged 16-44 years, to 14 and 16 per cent of men and women aged 45-64 years, respectively. This seems to suggest that self-employed people are less likely to have health or disability problems than the general working population, but it is not absolutely clear whether the same questions were asked in the GHS and the LFS although both are concerned with health, disability or illness which limits activity.

However, studies of specific groups of self-employed people bring different perspectives. Marsh *et al.* (1981) found a rather high proportion of self-employed construction workers, over 15 per cent, who reported some problem with health or disability, especially respiratory problems,

arthritis, and back injuries, which prevented them doing the kind or amount of work they would choose. Hakim (1987) reported that the health of homeworkers, some of whom would be categorised as self-employed, was somewhat better than the health of the working population as a whole. However, qualitative interviews with low-earning women homeworkers, more than a half of whom were paid 'in cash' (Cragg and Dawson, 1981) showed that many revealed poor health. The apparent discrepancy between these results may be due to different methodologies.

Eardley and Corden (1996a) suggest that self-employment can be attractive for some people with disabilities or health problems. It can allow them to work from home and offers greater flexibility in working hours and times than much employment. There does seem to be some evidence of such benefits from a survey on employment and handicap (Prescott-Clark, 1990) which recorded that about half of those in self-employment with a health or disability problem said their choice had been influenced by their health problems. Those who had switched to self-employment after the onset of health or disability problems formed more than half of the self-employed with a health or disability problem. Although the levels of disability were the same for the self-employed and the employed population, whether officially assessed by the Disability Registration Scheme or estimated on disability scales from survey responses, the self-employed recorded a higher level of occupational difficulties than their employee counterparts. Even among the disabled, the self-employed worked longer hours than employees, but some of the self-employed reported that sometimes they did not work their full hours. While flexibility of this kind may be a long-term advantage in keeping in work, it might make it harder to recognise liability for National Insurance or to keep up with payments.

The Enterprise Allowance Scheme (EAS) was always open to people with disabilities, and up to 1990 between three and eight per cent of participants were disabled, with 5,500 new participants with disabilities registered in 1989/90 (Department of Employment, 1990). Some evidence suggests that the take-up by disabled people of the Business Start-up Scheme, which replaced EAS in 1991, is lower than for the EAS (Tremlett, 1993). The Disability Working Allowance, introduced in April 1992, is also used to encourage people into self-employment and a relatively high proportion of recipients are self-employed. Early findings suggested that 25 per cent of recipients were self-employed (Rowlingson and Berthoud, 1994) and analyses of more recent

cohorts suggest that about one in five were working for themselves (Rowlingson and Berthoud, 1996).

There are few figures which estimate the prevalence of self-employment among carers, but there is some qualitative evidence that carers do use self-employment as a way to cope with their responsibilities (Twigg and Atkin, 1994; Eardley and Corden, 1996a).

In summary, there is not a full picture of the health characteristics of the self-employed population. For individual people, aspects of their own health or disability, or their caring responsibilities for others might have important links with attitudes to paying contributions, or abilities to maintain payments, and, given more information, it might be worth considering ways of targeting information using vehicles such as disability or carers' benefits delivery mechanisms, and outlets such as hospital waiting areas.

Ethnicity

The importance of self-employment for some ethnic minority groups in the UK is well-known. Much of the work that has been done in this area has been within small-scale studies, focussing on business developments in local areas, but the LFS and GHS also provide a national overview.

Table 2.8 presents the most recent national data, and shows that 4.2 per cent of self-employed people are from ethnic minority backgrounds, which is the same as the proportion among employees. Self-employed women are less likely than men to be from ethnic minorities. Perhaps more interestingly, Table 2.8 shows the greater likelihood of self-employment among people from Chinese, Pakistani/Bangladeshi and Indian backgrounds than White or Black backgrounds. Among those working, one in four Chinese people is self-employed compared with around one in seven of those originating from the Indian sub-continent and one in 12 Black people.

Table 2.8: Ethnic groups and self-employment, Great Britain, winter 1995-96

	<i>Self-employed</i>						<i>Self-employed as percentage of all employed</i>		
	all		men		women		all	men	women
	thousands	%	thousands	%	thousands	%			
White	3052	95.8	2287	95.5	765	96.8	12	17	7
All ethnic minorities:	135	4.2	109	4.5	25	3.2	12	17	5
Black	26	0.8	22	0.9	*	*	8	14	*
Indian	54	1.6	43	1.8	10	1.3	15	20	6
Pakistani/Bangladeshi	26	0.8	25	1.0	*	*	18	21	*
Chinese	13	0.4	*	*	*	*	24	*	*
Other origins	17	0.5	11	0.5	*	*	9	10	*
Total white and all ethnic minorities	3187	100	2396	100	790	100	12	17	7

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

* Insufficient cases for a reliable estimate

In the early 1980s the group with the highest self-employment rate was that of people from the Mediterranean Commonwealth (Cyprus, Malta and Gibraltar) (Curran and Burrows, 1989). Although the numbers of self-employed people from minority groups increased rapidly throughout the 1980s, the ranking of the self-employment rates of the different ethnic communities remained similar, except that self-employment among people whose origins are in the Indian sub-continent has overtaken that of the Mediterranean commonwealth groups. The gap between the self-employment rates of those in the ethnic minorities and of the white British population has widened (Eardley and Corden, 1996a). The increase in self-employment for the ethnic minority communities is greater than for white workers.

Dex and McCulloch (1995), using data from the 1994 LFS, showed that Asian and Chinese men who were self-employed were more likely to have employees (38 and 50 per cent respectively) than White (25 per cent) or Black men (around nine per cent), but this was not the case for self-employed women.

A number of small-scale studies provide a picture of entrepreneurial activity among minority groups (for example, Asian and Afro-Caribbean business, Wilson and Stanworth, 1988; Jewish business, Pollins, 1984; Turkish Cypriot business, Ladbury 1984; Asian business, Cater, 1984). These studies have drawn attention to the important reliance for financial and other kinds of help from other members of the same community, and the use of unpaid work from families. In the Asian businesses, there were often patterns of privileged access to supplies, credit terms and premises through family or community connections. However, it would be wrong to equate ethnic minority self-employment solely with 'business'. At the other end of the spectrum of self-employment, Mitter (1986) and Phizacklea and Wolkowitz (1995) describe how particular occupations are predominantly undertaken by people from particular racial groups amongst clothing industry workers and other homeworkers doing manual work for low earnings, on a self-employed basis.

Geographical distribution of self-employment

Many of the Contributions Agency's initiatives to identify self-employed people and encourage compliance with Class 2 NICs take place at a local level, from field offices. There is thus considerable interest in the geographical distribution of the self-employed population.

Table 2.9 shows that by far the greatest number of self-employed people are in the South East, of whom the majority are in the 'rest of the South East' rather than Greater London. The region with the next greatest number of self-employed people is the South West, whereas those areas with relatively low numbers of self-employed people are Northern Ireland, the North, and East Anglia. Scotland and the North have the lowest incidence of self-employment. This may be a result of the overall numbers of people in the different regions, but it does serve to locate the areas where there are large numbers of self-employed people and where the CA needs to focus its efforts in raising contributions.

The third column in Table 2.9 controls for the size of the population in each region and gives information on the regions where self-employment is most likely. The incidence of self-employment is at its greatest, at 16 per cent of all those in work, in the South West, compared

with an average of 12 per cent in the whole of the UK. This region also has relatively high numbers of self-employed people, second only to the South East. The rate of self-employment varies from ten to 16 per cent over the different regions.

Table 2.9: Regional distribution of self-employment, Great Britain, winter, 1995-96

	<i>Self-employment</i>		<i>Self-employed as a percentage of all in work</i>
	thousands	%	
United Kingdom	3268	100	12
Great Britain	3188	98	12
England	2807	86	13
South East	1159	35	14
Greater London	424	13	14
Rest of South East	735	22	14
East Anglia	139	4	14
South West	359	11	16
West Midlands	251	8	11
East Midlands	210	6	11
Yorkshire and Humberside	258	8	12
North West	304	9	11
North	126	4	10
Wales	161	5	14
Scotland	219	7	10
Northern Ireland	81	2	12

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

Table 2.10 lists the counties and larger local authority districts with more than 50,000 self-employed people, extracted from a detailed list of the numbers of self-employed people in all counties and larger local authority districts in the UK, in the *Labour Force Survey Quarterly Bulletin*, June 1996. There are particularly high numbers of self-employed people (over 100,000) in Essex, Kent, West Yorkshire and Greater Manchester. Taking the geographical analysis even further, Table 2.11 lists local authority districts with more than 20,000 self-employed people, and this list may reflect the relatively high rate of self-employment in areas with a high ethnic minority population. Note that Barnet is the only district within Greater London with more than 20,000

self-employed people, although, of course, there is a concentration of self-employment in the overall London area (see Table 2.9).

Table 2.10: Counties and larger local authority districts with more than 50,000 self-employed people, winter 1995-96

	<i>Thousands</i>
Greater Manchester	120
Essex	110
Kent	108
West Yorkshire	104
West Midlands	95
Hampshire	91
Devon	89
Lancashire	82
Surrey	76
Strathclyde	76
Hertfordshire	62
Avon	62
South Yorkshire	62
East Sussex	59
Norfolk	58
Merseyside	53
Dorset	51
North Yorkshire	51
Staffordshire	51
Nottinghamshire	51
Cheshire	50

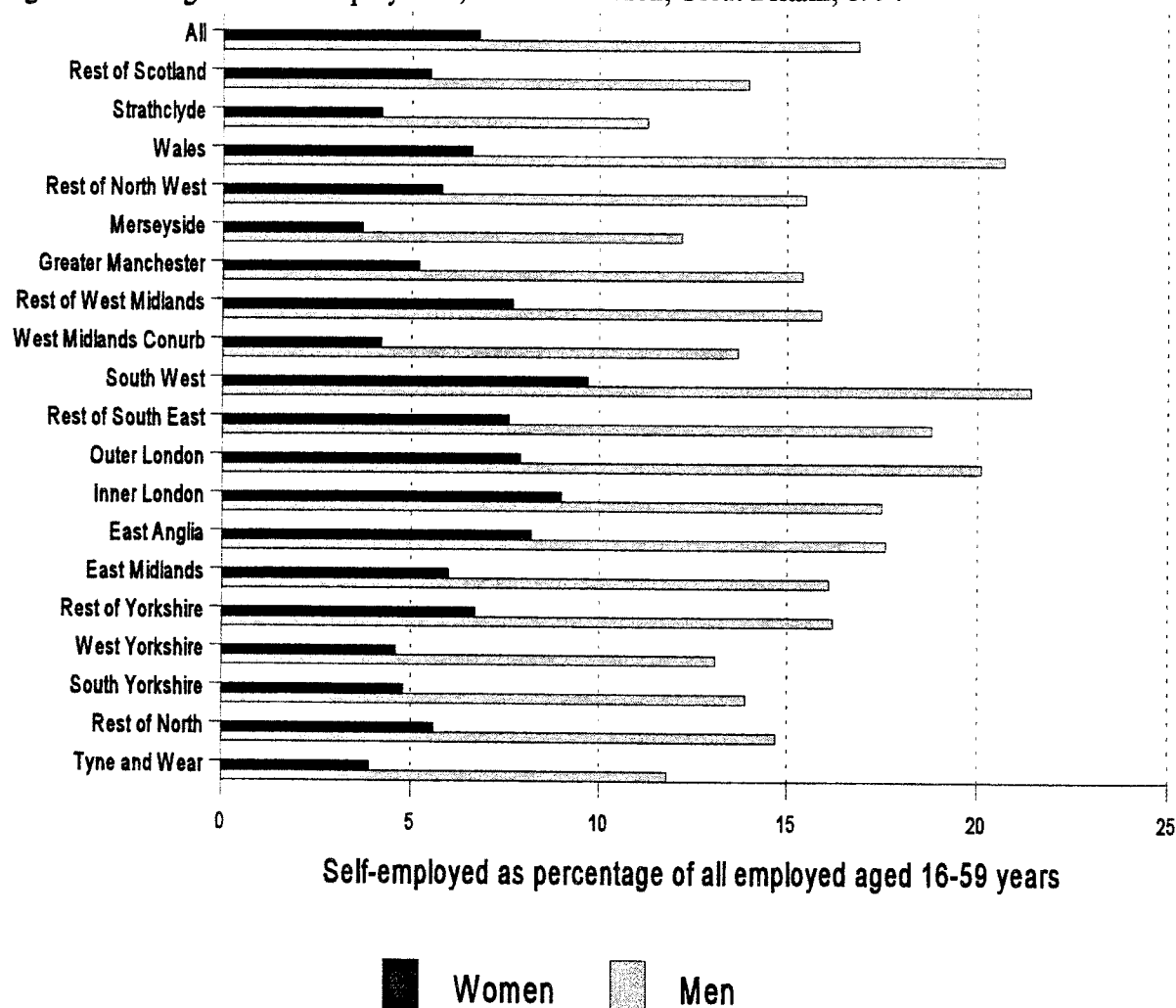
Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

Table 2.11: List of local authority districts with more than 20,000 self-employed people, winter 1995-96

	<i>Thousands</i>
Leeds	37
Birmingham	31
Barnet	26
Kirklees	25
Bristol	24
Sheffield	22
Bradford	22

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

Figure 2.1: Regional self-employment, women and men, Great Britain, 1994



We have included considerable detail on the numbers of self-employed people geographically because of the particular focus of this report, but Dex and McCulloch (1995) give a more detailed breakdown of the likelihood of being in self-employment for men and women in different regions for the spring of 1994, shown in Figure 2.1. Regions with the highest rates of men's self-employment are the South West, Wales and Outer London, followed by the rest of South East, Inner London and East Anglia. Strathclyde, Merseyside and Tyne and Wear have the lowest rates of male self-employment. The regions with the highest rates of female self-employment are the South West, Inner London, East Anglia, Outer London, the rest of the South East, and the rest

of the West Midlands. The areas with the lowest rates of female self-employment are Tyne and Wear, West and South Yorkshire, the West Midlands conurbation, Merseyside, and Strathclyde, all with less than five per cent of working women in self-employment.

Ellison and Newman (1994) present analyses for even smaller geographical areas. They show that overall rates of self-employment vary from 39.6 in Powys to 7.0 per cent in Tyne and Wear. Their analysis shows that the rate is highest in agricultural areas in west and north Wales, and in the south-west corners of England and Scotland, East Sussex and the Isle of Wight. A local area database, including details of self-employed work, from the Labour Force Survey, has recently become available (Wood, 1996).

One of the debates about the growth of self-employment is whether this form of work is a response to unemployment. In discussing the regional distribution of self-employment, Dex and McCulloch (1995), using data from the British Household Panel Study, show that the travel-to-work areas with low levels of unemployment are more likely than others to have higher levels of self-employment. (Travel-to-work areas are used to define local labour market areas where a minimum of 75 per cent of the journey-to-work trips both started and ended in the area). They claim that the association they find between self-employment and more buoyant labour markets is not surprising in that small businesses are often considered to be the engines for economic growth.

The statistics presented in this section show that it is possible to estimate the numbers of self-employed people at the level of counties and individual local authority districts. Census data enables estimates for even smaller areas, but are available only every ten years, of course. As we see in the next section, the self-employed population is volatile, and census counts in small areas are unlikely to be reliable for long.

An indicator of where future self-employment is likely to be located is given by the labour market projections for different regions. In the debate about whether self-employment results from high unemployment or from a more buoyant labour market, there is a difference between entrance into self-employment and continuing in self-employment. The latter seems to be more linked to expanding labour markets. Ellison (1995) shows that the strongest labour market growth is in

East Anglia, and, to a lesser extent, the South West, the East Midlands, the North East and the South East. The female labour force is projected to grow strongly in all regions but particularly East Anglia, the East Midlands and the South West. An older age structure for the work force is projected, and this may have a greater influence than general employment levels on the growth in self-employment, as the age-structure of the self-employed population is older than that of employees.

Flows into and out of self-employment

This chapter began with a description of the rise in self-employment during the past two decades, but in any given year there is also a substantial flow into and out of self-employment (see Eardley and Corden (1996a) for a discussion of the evidence). The numbers entering self-employment vary more than the numbers leaving, and the net change from year to year in the numbers in self-employment is influenced more by the numbers starting than finishing. One reason proposed for the greater variation in the numbers starting than leaving self-employment is that there may be clusters of people who all move into self-employment at the same time, because of the timing of employment initiatives, or patterns in the unemployment cycle. There are unlikely to be similar influences on the timing of business ending, which can happen at any time throughout the year.

In the following discussion it is important to remember that for individual self-employed people, their experience may not be reflected in the concept of 'entering' or 'exiting' self-employment. For example, the son of a farmer who has always helped on the family farm may find it hard to point to the time at which he 'entered self-employment'. Similarly, businesses may go through a long period of decline and collapse, and the finishing date agreed may depend more on tax and social security arrangements than on trading patterns. Nevertheless, the following statistical analyses are useful.

Younger people, aged 16-24 years, and women have a higher likelihood of starting self-employment than others, and they also have a higher rate of leaving. There is a high turnover among these groups, who seem to try self-employment for relatively short periods. Campbell and Daly (1992) showed that entry rates for men fell between 1989 and 1991 from 19 to ten per cent of the total of self-employment, but exit rates rose from ten to 14 per cent over the same interval. This was after a period of relatively high entry rates throughout the 1980s, particularly for

women, for whom entry rates reached 27 per cent in 1984. Exit rates for women had been stable between ten and 15 per cent through the 1980s, but have been slightly higher at just over 16 per cent for the 1989 to 1991 period. Daly (1991) presents the numbers of people, men and women, starting and finishing self-employment. The average annual number of people starting self-employment during the period 1981-1989 was 414,000, and, on average, 258,000 people left self-employment each year.

The Contributions Agency will be specially interested in the previous economic activity of new entrants to self-employment, because this may offer some ideas about how to target appropriate information about Class 2 NICs. Campbell and Daly (1992) show the previous economic activity of new entrants to self-employment for the years 1983 to 1991, and give an average of the transitions over these years. Men were most likely to have moved from being an employee (61 per cent of new entrants), followed by 22 per cent from unemployment, and ten per cent from economic inactivity. The remaining seven per cent came from a category defined as 'other in employment', which is not defined in the publication, but as it does not include formal employees may include some less formal employment arrangements. Women, on the other hand, were more likely to enter self-employment after a period of inactivity in the formal labour market (45 per cent), than from employment (37 per cent), and relatively few, ten per cent, entered from unemployment. The remaining eight per cent came from the 'other in employment category'. This suggests that it may be worth promoting information about Class 2 NICs in Job Centres. On the assumption that at least some of those moving out of periods of economic inactivity into self-employment visit Job Centres to see what is generally on offer, as well as unemployed people, considerable numbers of 'new entrants' might have a chance of seeing a poster or leaflet about Class 2 NICs. Occasional reminders about the contribution system for self-employed people sent to personnel managers of firms, especially those facing large scale redundancies, might also have a chance of reaching a proportion of people considering a move to self-employment.

At the other end of a period of self-employment, similar percentages of men and women leave for employment (around 45 per cent) with men twice as likely to become unemployed (33 per cent) as women (15 per cent) although the reverse is true for those leaving self-employment to become inactive in the labour market. Bryson (1996) has reviewed the literature on movements in and out of self-employment.

Bryson and White (1996) used the Restart Cohort Survey to look at the predictors of going into self-employment rather than employment for the long-term unemployed (those claiming benefits for at least six months). The main predictor of moving into self-employment was previous experience of self-employment. For women, but not men, a previous experience of the Enterprise Allowance Scheme increased the likelihood of going into self-employment. Among both men and women, those moving into self-employment were more likely to be workers with higher qualifications or better work histories. Men were more likely to go into self-employment in a buoyant labour market, whereas women seemed more likely to be 'pushed' by unemployment. Living with a domestic partner who did paid work, or others in the household who worked, raised men's chances of becoming self-employed whereas women were more likely to become self-employed if they lived in owner-occupied accommodation rather than rented accommodation. There was little evidence that propensities towards risk-taking encouraged the long-term unemployed into self-employment. Blanchflower and Oswald (1990), in an analysis of the British Social Attitudes Survey, suggest that employees are put off self-employment by the lack of start-up capital and, to a lesser extent, by the risks involved.

Much has been written about the reasons why people enter self-employment, and there are a range of 'push' and 'pull' factors. The attraction of independence and 'being your own boss' is frequently cited, along with the challenge, the freedom to choose when and for whom to work (Hakim, 1989a; Scase and Goffee, 1982; Blanchflower and Oswald, 1990). 'Push' factors include having been made redundant (Johnson and Rodger, 1983), being unemployed, exclusion from local employee labour markets by racial discrimination, or needing to fill a gap before going to college. The ability to fit in with domestic and child rearing work can be a strong motivation for some women (see Eardley and Corden, 1996a). Health can also be a 'push' factor as described earlier in this chapter. Some work is traditionally organised mainly as self-employment, and for people choosing these occupations, the career choice determines their employment status. Trades unions reported in 1993 that people seeking work in construction and agriculture were often told that work was available only on a self-employed basis (IIAC, 1993). Some authors have suggested that 'market factors', for example being forced by unemployment or redundancy or seeing a gap to be filled, are more important for men, whereas women are more likely to be motivated by 'non-market factors' such as family needs, ambition or chance (Storey and Strange, 1992).

Another way of looking at flows through self-employment is to consider the length of time that individuals spend in any continuous period of self-employment. This is an indication to the Contributions Agency of how long any one person remains liable to pay Class 2 NICs.

Table 2.12 shows that 67 per cent of men in full-time self-employment have been self-employed for five years or more, 16 per cent for two to five years and 17 per cent for under two years. Women are less likely to have been in self-employment for five years or more: 59 per cent of those working full-time and 49 per cent of those working part-time. Women working part-time are the most likely to be recent entries to self-employment. Among part-time self-employed women, 26 per cent had been self-employed for less than two years compared with 19 per cent of women working full-time.

Table 2.12: Length of time in continuous self-employment, Great Britain, 1994

	<i>Men full-time</i>	<i>Women full-time</i>	<i>Women part-time</i>	<i>All</i>
	%	%	%	%
Less than 2 years	17	19	26	18
2 years but less than 5 years	16	22	24	18
5 years or more	67	59	49	64
Number in survey	842	184	182	1208

Source: 1994 GHS (Table 8.13)

Dex and McCulloch (1995) show that 65 per cent of all men in self-employment, and 76 per cent of those with employees have been self-employed for three years or more. A lower percentage (60 per cent) of full-time permanently employed men have been with their current employer as long. Although 64.4 per cent of self-employed women with employees have been in this situation for three years or more, women are less likely both to have been with their current employer as an employee, or to have been self-employed, as long as men.

There is also information available about the experience of self-employment over the lifetime. Drawing on BHPS data, Dex and McCulloch (1995) showed that more than a quarter of men (26.8 per cent) had experienced self-employment at some time during their working life. This

compares with the 16.9 per cent rate of male self-employment in 1994, noted earlier in this chapter. Figures for women were lower: 9.1 per cent had experienced self-employment at some time. Information is not readily available in the literature on the number of spells of self-employment or of periods of self-employment in combination with other forms of paid work. This information could be extracted through secondary analysis, for example of the British Household Panel Study.

Conclusions

This chapter has provided information about the main demographic and personal characteristics of the general self-employed population, which will form a useful basis for comparison with the Contributions Agency own administrative statistics and current customer profiles. The authors did not make comparisons with the characteristics of the Agency's self-employed customers using the selective published tables in the Customer Satisfaction Surveys, which are based on customers in recent contact with the Agency, but this might be pursued.

The geographical distribution and concentration of self-employment are interesting, and may be helpful in guiding local initiatives to encourage compliance. Other possible 'targets' have been identified throughout the chapter, for example certain ethnic minority communities, people moving out of unemployment, and people with health or disability problems. There are important gaps in detailed knowledge about the links between health and disability, or caring responsibilities, and self-employment, however, and this is an area in which further work might be helpful. Although those from the ethnic minorities and people with health and disability problems are a small proportion of the total self-employed, self-employment is a valuable source of economic activity and the cover provided by NICs is important for such people.

Findings about the lifetime experiences of self-employment, and the economic activity of people prior to a period of self-employment, point to the need for wide dissemination of information about Class 2 liabilities among the general population. This might help people to arrive in a period of self-employment with appropriate knowledge, and represents a different approach from targeting those people who have already arrived. Both approaches, of course, might be pursued by the Contributions Agency.

CHAPTER THREE

THE KINDS OF WORK DONE BY SELF-EMPLOYED PEOPLE

This chapter is concerned with the kind of work that is done on a self-employed basis, to start to build a picture of the occupations and activities of those of the Contributions Agency customers who have a Class 2 liability. The first section describes the occupational distribution of the self-employed population, and the second, the distribution by industrial sector. The third section shows the amounts of work done, on an hourly basis, and fills in more of the picture of self-employed people's work by describing their level of training and general qualifications, and other characteristics such as union membership.

Occupational distribution

Table 3.1 shows the occupational distribution of self-employed people, comparing men and women alongside the occupational distribution of all employees. Classification is according to the Standard Occupational Classification (SOC) used in the Census and is fairly self-explanatory except perhaps the categories 'Craft and related' and 'Personal and protective services'. 'Craft and related' occupations include skilled construction trade workers, skilled engineers, and other skilled trades. Personal and protective services include policemen, firemen, hospital and care workers.

In general, all people in work are more likely to be in non-manual than manual occupations, but there is a lower proportion of self-employed workers than employees in non-manual occupations, 54 per cent compared with 61 per cent. Among the self-employed, men are more likely to be in manual than non-manual occupations and women much more likely to be doing non-manual work.

Table 3.1: Distribution of self-employment over different types of occupation, Great Britain, winter 1985-96

	<i>All self-employed %</i>	<i>Self-employed men %</i>	<i>Self-employed women %</i>	<i>All employees %</i>
All	100 (=3,188,000)	100 (=2,397,000)	100 (=790,000)	100 (=21,982,000)
Manual	46	53	26	39
Non-manual	54	47	74	61
Managerial/ administrative	23	20	31	15
Professional	12	13	11	10
Associated professional and technical	11	10	16	9
Clerical	3	1	11	16
Craft and related	28	36	4	10
Personal and protective services	4	1	13	12
Selling	4	4	5	9
Plant and machine operators	7	9	2	10
Other occupations	6	6	7	9

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

By far the most common occupational class for the self-employed is 'craft and related' work, followed by managerial and administrative work and, at a considerably lower level, professional workers. This distribution also reflects the common occupational pattern of men in self-employment. The pattern of occupation for self-employed women is different, with 31 per cent in managerial and administrative jobs, 16 per cent in associated professional and technical work, and only four per cent in craft and related work. Self-employed women are also more likely than men to be in clerical or personal and protective services work. In comparison, the most common work for employees is clerical followed by managerial and administrative, and then personal and protective services.

Some types of work are more amenable to self-employment than others - or are traditionally done by people working as self-employed. Table 3.2 shows the kinds of work where self-employment is relatively more common, for example in manual rather than non-manual work.

Table 3.2: Percentage of people in each occupational category who are self-employed, Great Britain, winter 1995-96

	<i>All</i>	<i>Men</i>	<i>Women</i>
All occupational categories	13	17	7
Manual	15	19	6
Non-manual	11	16	7
Managerial/administrative	18	18	18
Professional	15	19	8
Associated professional and technical	15	20	11
Clerical	3	3	3
Craft and related	29	31	11
Personal and protective services	5	3	6
Selling	6	13	3
Plant and machine operators	9	11	3
Other occupations	9	14	5

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

As we see in Table 3.2, 15 per cent of those in manual work are self-employed compared with 11 per cent in non-manual work. Among male manual workers self-employment is even more common, accounting for nearly one in five men. Almost one in three men working in craft and related jobs is self-employed, one in five of those in associated professional and technical occupations, and slightly fewer than one in five of men working in managerial and administrative jobs or professional work. For women's occupations there is a lower prevalence of self-employment - only in managerial and administrative work does it approach that for men - 18 per cent of women doing this kind of work are self-employed. (Lists of typical self-employed occupations are found in Table 4, 1991 Economic Activity, Vol. 1, OPCS, HMSO, London).

Dex and McCulloch (1995) give the likelihood of self-employment in more detailed occupational categories. Table 3.3 is based on their analysis and highlights the high proportion of self-employed people among agricultural managers, health professionals, other professional men, other associate professionals, skilled tradesmen, and women in 'other elementary' occupations.

Table 3.3: Percentages of all employed in each occupational category who are self-employed, Great Britain, spring 1994

	<i>Men</i>		<i>Women</i>	
	Percentage self-employed	All working in category (000s)	Percentage self-employed	All working in category (000s)
Corporate managers	3.1	1729	4.1	808
Managers in agriculture	53.0	797	44.3	428
Science and engineering professionals	11.8	547	(6.9)	73
Health professionals	43.6	117	31.5	65
Teaching professionals	4.0	379	4.6	635
Other professionals	27.9	427	7.9	222
Science and engineering associate professionals	6.5	468	(5.6)	99
Health associate professionals	11.6	89	4.3	592
Other associate professionals	27.8	622	20.0	449
Clerical and secretarial	1.9	893	2.8	2750
Skilled trades	31.0	2865	14.1	306
Protective services and personal services	2.5	803	5.2	1584
Buyers and brokers	16.0	304	11.3	107
Other sales	11.5	371	2.4	1081
Industrial plant, drivers, and machine operators	4.5	962	2.4	434
Other elementary	8.1	966	21.1	91
All occupations	17.1	12339	6.7	9724

Source: Dex and McCulloch (1995), Tables 5.3 and 5.4
() based on small cell size

Self-employment in industrial sectors

This section describes the patterns of self-employment in different industrial sectors. It is not possible, using published data, to present links between the occupational and industrial distributions of self-employed people. If having employees is one indication of possible managerial responsibilities, we might infer that men and women managers are likely to be found

within the distribution, hotels, transport and retailing industries. Further secondary analysis of Labour Force Survey data would readily provide information about occupational categories within industrial sectors.

As shown in Table 3.4, almost one in three self-employed men worked in the construction industry in the winter of 1995/1996, and because of the dominance of men among the self-employed, nearly a quarter of all self-employed people worked in construction. Over a quarter of self-employed women and 20 per cent of all self-employed people worked in distribution, hotels and restaurants. Relatively high proportions of self-employed women worked in banking and finance and public administration, education and health, and 'other services'. This last category includes a wide range of personal and small-scale service enterprises such as hairdressing, cleaning, dressmaking. Hence the great majority of self-employed women (85 per cent) work in the service sector, whereas just over half of self-employed men work in services. The dominance of construction work for self-employed men is striking, and not reflected among employees.

Table 3.4: Distributions of self-employment over different industries, Great Britain, winter 1995-96

	<i>All self-employed %</i>	<i>Self-employed men %</i>	<i>Self-employed women %</i>	<i>All employees %</i>
All	100 (=3,188,000)	100 (=2,397,000)	100 (=790,000)	100 (=21,982,000)
Agriculture and fishing	7	8	6	1
Energy and water	*	*	*	1
Manufacturing	7	7	7	21
Construction	24	31	2	4
Distribution, hotels and restaurants	20	18	26	20
Transport and communications	6	7	2	6
Banking, finance and insurance	16	16	16	14
Public administration, education & health	9	5	22	27
Other services	10	7	18	5
Total services	61	53	85	72

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

* insignificant numbers

If the Contributions Agency is interested in targeting specific industries, this is easier for self-employed women than men. Eighty-two per cent of self-employed women work in four industries: distribution, hotels and restaurants; public administration, education and health; banking, finance and insurance; and other services. Over half of self-employed men work in three industries: primarily construction; distribution, hotels and restaurants; and banking, finance and insurance.

Although relatively few people work in the agricultural industry (seven per cent of the self-employed and one per cent of employed people), just over half of those in agriculture are self-employed. The likelihood of being self-employed in the agricultural industry is relatively high for both men and women at 55 per cent and 42 per cent respectively, as shown in Table 3.5. Nearly half of men working in construction are self-employed, nearly a quarter of those in other services and a fifth of men in banking, finance and insurance.

Table 3.5: Percentage of people in each industry who are self-employed, Great Britain, winter 1995-96

	<i>All</i>	<i>Men</i>	<i>Women</i>
All	13	17	7
Agriculture and fishing	52	55	42
Energy and water	*	*	*
Manufacturing	5	5	4
Construction	45	49	10
Distribution, hotels and restaurants	12	18	8
Transport and communications	11	13	5
Banking, finance and insurance	15	20	8
Public administration, education and health	5	6	4
Other services	21	24	18
Total services	11	15	7

Source: *Labour Force Survey Quarterly Bulletin*, Number 16, June 1996

* insignificant numbers

The Contributions Agency will also be interested in the distribution by industry for different age groups, shown in Table 3.6. One pattern to note here is the falling-off in male self-employment in the construction, manufacturing and extraction industries in older age groups. Marsh *et al.* (1981), from a national study of construction workers, suggested that considerable numbers of men became unable to work the long hours required or were 'invalided out' of the construction industry prior to reaching retirement age, as a result of health conditions which many believed were associated with working conditions. If this general pattern was recognised by younger men in the industry, there might be some effect on attitudes to making contributions (Class 2 NICs do not give access to industrial injuries benefits, although, of course, they do count towards an old age pension).

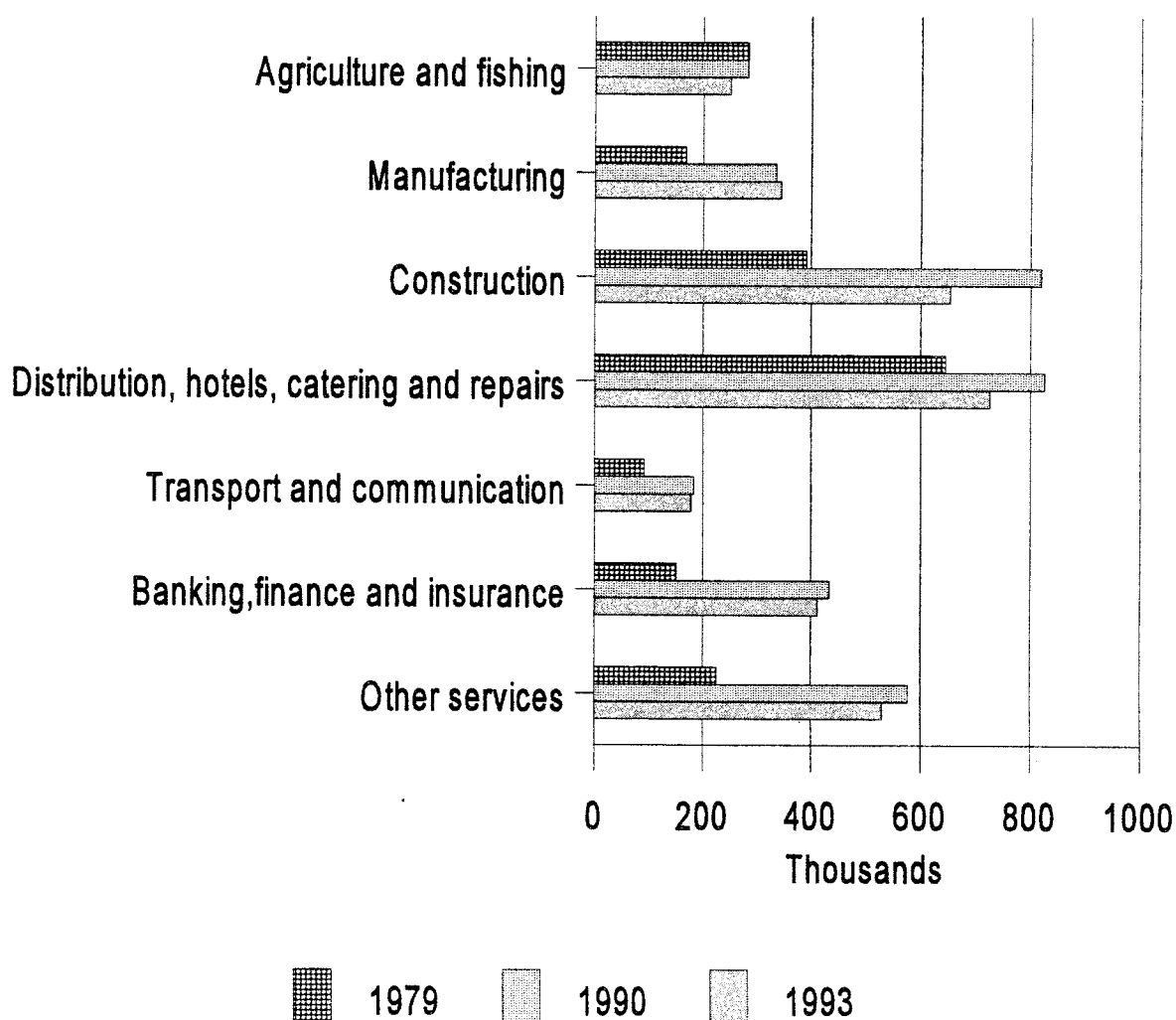
Table 3.6: Distribution of self-employed people over three industrial categories for different age groups, Great Britain, spring 1994

	<i>Agriculture, forestry and fishing</i>	<i>Manufacturing, construction, extraction of minerals and metals</i>	<i>Distribution, transport, banking and other services</i>	<i>Total of self- employed</i>
	%	%	%	
All aged 16+ years	7.6	33.4	58.9	3,207,707
Men	8.3	40.7	51.0	2,388,738
Women	5.7	12.0	82.1	818,969
All aged 16-24 years	7.8	48.0	43.9	171,625
Men	8.3	56.9	34.5	138,439
Women	5.7	10.8	82.9	33,186
All aged 25-49 years	6.1	35.1	58.6	2,054,682
Men	6.8	43.3	49.3	1,504,653
Women	4.2	12.5	84.1	550,029
All aged 50-59/64 years	9.1	30.3	60.5	791,297
Men	9.1	34.7	56.1	643,056
Women	9.5	11.0	79.2	148,241
All over state pension age	16.7	14.1	69.1	190,103
Men	22.2	16.4	61.4	108,590
Women	9.6	11.1	79.3	81,513

Source: Tillsley, 1995

Figure 3.1 shows that between 1979 and 1990 the numbers in self-employment increased in all sectors except agriculture and fishing. Numbers doubled in construction, increased by two and a half times in other services and nearly trebled in banking, finance and insurance. Meager *et al.* (1992) suggest that this growth in service sector self-employment was not only a result of the overall movement in the labour market from manufacturing to services but because of a differential growth in self-employment in particular services. Between 1990 and 1993 numbers fell by small amounts in all sectors except manufacturing, and there was as much as a 20 per cent decline in the numbers of self-employed in the construction sector. The decline in self-employment was relatively small during a period of recession in the early 1990s.

Figure 3.1: Self-employment trends in industrial sectors, Great Britain, 1979-93



Source: Labour Force Surveys, 1979-93

Hours worked

In some cases, the amounts of work that self-employed people do can be hard to quantify. Farmers, for example, may explain that they are engaged on work-related activities all their waking hours while people engaged in creative work, such as authors or poets, have to decide whether to count 'thinking time' (Eardley and Corden, 1996a). Statistical analyses of hours worked are available, however, and contribute to the picture of self-employed work.

The previous chapter (p23) described the patterns of full-time and part-time work among self-employed people. Butcher and Hart (1995) present a detailed analysis of working hours, and trends for the period 1979-1994. They show that the average hours per week worked by the self-employed has declined from 47.8 in 1979 to 39.4 in 1994 (Butcher and Hart, 1995). This is related to the increase in part-time self-employment, which, together with a considerable increase in the hours worked by employed people, has tended to close the gap between the average hours worked by employees and the self-employed. Thus, the usual hours worked by self-employed workers fell from 50.0 in 1979 to 44.5 in 1994, and rose for employees from 41.4 in 1979 to 43.8 in 1994. (The usual hours worked are obtained from responses to 'what are your usual hours of work per week?', rather than 'what hours did you work last week?', from which the average hours worked per week is calculated.)

More recent data for the actual hours worked refers to the winter of 1995-6 (*Labour Force Survey Quarterly Bulletin*, 1996, June). Self-employed men, who described themselves as working full-time, worked 42.7 hours in the previous week on average, and full-time self-employed women, 40.9 hours. Full-time male employees worked 36.7 hours per week and female employees 33.2 hours. Those who had second jobs as self-employed spent, on average, 8.5 hours in this work, with little difference between men and women. Part-time self-employed women worked 11.3 hours per week on average and this compares with 15.2 hours per week for part-time women employees. The overall picture is that self-employed people tend to work longer hours, on average, than employees, and self-employed men with employees work longest hours of all. In 1983-84 self-employed men with employees worked 55.9 hours per week on average compared with 47.6 hours per week for those with no employees and 39.6 for male employees (Curran and Burrows, 1989). Among those working 30 or more hours per week, self-employed men with employees averaged 58.5 hours per week compared with 49.9 for those without

employees and 40.7 for employed men. 'Second jobs' are, on the whole, rather modest commitments in terms of working hours, (and may generate similarly modest earnings).

A further aspect of working hours is their distribution by industry. Longer working hours are most common among self-employed people, both men and women, who are engaged in agricultural work and services. Longer working hours are least common in construction. These figures provide an overall picture, however, and mask the seasonal variation in hours of work which are an important factor for some self-employed people. There are certainly some self-employed people, for example in agriculture, fishing, hotels and restaurants, who have little time for anything other than their work during parts of the year, and rely on the downturn in their trade or business cycle to catch up on paperwork associated with their business, or to spend more time on personal and domestic matters (Eardley and Corden, 1996a). People whose self-employment represents a second job may also have heavy commitments on their time. The time pressures experienced by self-employed people in dealing with paper work required, including National Insurance regulations, is further discussed on page 120.

Qualifications, training, and union membership

While for some people, dealing with Class 2 NICs might be a matter of finding time, for others it is possible that there may be issues of understanding and readiness to engage with paperwork or provide estimates of income. It may, therefore, be useful to look at general levels of education and training among the self-employed population.

Detailed analysis of the 1991 LFS by Campbell and Daly (1992) showed that the educational qualifications of the self-employed were generally higher than for employees: 53.2 per cent of the self-employed had A level or higher qualifications, compared with 44.5 per cent of employees. The proportions of the self-employed and employees with no qualifications were similar, 25.9 and 25.1 respectively. The rate of self-employment had risen between 1981 and 1991 for all levels of qualifications. Those with lower level qualifications were more likely to be working on their own. The level of qualifications in different industries is not available in published tables, but could be readily obtained through secondary analysis of the LFS.

The LFS asks people whether they have had any job-related training in the previous four weeks, and compared with people in other types of employment, self-employed people were considerably less likely to have experienced job-related training. Self-employed women were more likely to have received some training (8.5 per cent) than men (Dex and McCulloch, 1995). We do not know what kind of training had been undertaken.

Findings described above suggest that self-employed people, as a group, are unlikely to be at a general educational disadvantage in comparison with employees, in interpreting and understanding information. It would be useful to have more information about levels of education and qualifications in specific industries and occupations. One study from six selected labour markets (Rubery *et al.*, 1993) found the self-employed to be less well qualified than their employee counterparts, educationally. Care must be taken, therefore, in interpreting the evidence available about educational qualifications for the Contributions Agency.

One way of receiving information and advice about Class 2 NICs might be through trades unions. Union membership among self-employed men and women is rather low. Only 8.5 per cent of self-employed men are in a union compared with 40.5 per cent of full-time permanent employees (LFS Spring 1994 in Dex and McCulloch, 1995). The corresponding figures for women are 7.4 per cent of the self-employed and 38.9 of full-time permanent employees. Self-employed men with employees are more likely to be union members than those without (10.8 per cent compared with 7.7 per cent), but membership is similar for women irrespective of whether they have employees or not (LFS Spring 1994 in Dex and McCulloch, 1995). It is unlikely therefore that trades unions are going to provide an efficient means of communication with self-employed people.

Conclusions

The concentrations of self-employed people within certain occupations and industries mean that some targeting by the Contributions Agency may be possible, using these criteria. It is easier to target women than men, in terms of the kinds of work that people do.

If dealing with Class 2 NICs is a matter of finding time to catch up on business paperwork, then there may be problems for some self-employed people who work long hours, particularly at certain times of the year, or those who combine their work with a job as an employee. Large

national data sets suggest that self-employed people are at no great disadvantage relative to employees, educationally, if dealing with contributions is a matter of ability to understand information or fill in forms. However, national trends may mask the educational disadvantages of some of those who work as self-employed. There is scope for further investigation of people's ability to deal with information about Class 2 NICs, and understanding of requirements, and we return to this in Chapter Seven. It is unlikely that trades unions could provide an efficient means for encouraging compliance, since trade union membership among self-employed people is low.

CHAPTER FOUR

THE ORGANISATION OF SELF-EMPLOYED WORK

This chapter focuses on the heterogeneity of self-employment in terms of the variety of different forms of business arrangements and organisation. For purposes of Class 2 NICs, we are concerned with different kinds of sole proprietorships and partnerships in unincorporated businesses. It is worth looking briefly at the difference between incorporated and unincorporated businesses.

In legal terms, businesses which are incorporated under the Companies Act 1985 are companies limited by shares. The business belongs to the company, and the company belongs to the shareholders. Incorporated businesses enjoy limited liability, such that the directors (who may also be share-holders in small companies) know the extent of the potential personal financial liability should their trading prove unsuccessful. This is restricted to the initial share capital. On the other hand, unincorporated businesses are subject to increased surveillance and regulation, for example they must submit fully audited accounts. Freedman and Godwin (1992, p106) explain that business owners are likely to choose incorporation where there is a need to raise capital, where there is separation between ownership and control, a need to monitor management, and where limited liability is required.

All other forms of trading, business or service production represent unincorporated businesses. These are not subject to company law, and there are no rules about the format of their accounts, although, as might be expected, there have been some attempts to impose regulation for taxation purposes. Examples are the at source deduction of tax from earnings for some construction workers and agency workers. In general, sole trading or partnership might be appropriate for businesses where there was no need to raise equity capital, and in which all the owners were also involved in management. There is some evidence (Freedman and Godwin, 1992) that preference for paying Class 2 and Class 4 NICs as self-employed people, rather than the higher Class 1 NICs payable in respect of company directors, can be a reason for non-incorporation of some small businesses. Sole trading, as a business form, has minimal regulation under the Business Names Act 1985, while the Partnership Act, 1890 is described by Freedman and Godwin (1992, p106) as 'largely a voluntary code' in its provisions for relationships between the business owners.

The distinction between incorporated and unincorporated business leads to some problems in definition of employment status, and Chapter One described the position of company directors who hold a controlling interest in the company which employs them as a particular 'grey area'. This chapter is concerned with the different forms of organisation of **unincorporated** business, and as we might expect, these include some of the more modest forms of business and trade.

The first section of the chapter considers the main forms of self-employed work. This includes the familiar 'small business' or 'enterprise', as well as other kinds of so-called 'quasi-self-employment' such as subcontracting and franchising. Some self-employed people may choose to share the risks and rewards of their endeavours by working 'in partnership', and we consider what this may mean in terms of NICs.

Cutting across the different forms of work described, a distinction can be made between self-employed people who have formal employees and those who have none. This distinction is of interest to the Contributions Agency because people with employees may have responsibilities for employer contributions in respect of their employees who pay Class 1 NICs, as well as their own Class 2 and Class 4 NICs. The second section of the chapter thus considers self-employed people as formal employers of employees, and as users of the labour of other self-employed people. We look also at the use of unpaid labour, and what evidence there is of 'irregular work'.

An additional perspective, in the third section of the chapter, comes from looking for relevant information about those people who are both self-employed and employees. It seems likely that those who formally declare such a dual status represent only a proportion of the total number who work in this way occasionally or regularly, and this is pursued further in Chapter Seven.

Forms of self-employment

The extreme heterogeneity of self-employment is already well documented (Dale, 1986; Casey and Creigh, 1988). There is no satisfactory classification of different types of self-employed work. Indeed, Hakim (1988) argues that there is a pressing need for such a classification. We tend to agree with Hakim that, at present, the various forms of self-employment might be perceived as a continuum, or spectrum. At one end stands the traditional small business owner - the 'entrepreneur', with a handful of employees, looking for new business opportunities and

hoping to expand activities. At the other end are people whose circumstances of work are very little different from those of employees. Hakim (1988) calls these forms of work 'nominal self-employment', and we have already used the term 'quasi self-employment'. At this end of the spectrum we might put some subcontracted workers, or homeworkers working for a single employer or organisation.

Within the spectrum, or, in Hakim's terms 'somewhere in between the two extremes' (1988, p445) there are professional self-employed people, craft workers, family undertakings in which business and personal life are hard to disentangle, newer organisational forms such as franchises and co-operatives, and traditional, distinct ways of earning a living such as childminding.

The spectrum described above provides a framework for this section of the chapter, which goes on to look at some of these different kinds of work. As a typology, or classification, however, the framework needs refinement. It is hard to find reliable estimates of the numbers of people working in each form of self-employment.

The small business

Probably the most familiar form of self-employment is the small business, and it is the businesses operating from non-domestic premises, with a handful of employees, that have received most attention (Curran, 1990). There is a range of literature which provides information about the role and organisation of small businesses. Curran (1986; 1989) reviews literature of theories and findings about social relations in small businesses, and goes on (1990) to look again at conceptual and theoretical issues relevant to a direct focus on small-scale economic activity. He looks at the concept of the '*petit bourgeois*', and their class situation in the wider social and economic context, and searches for the character of the 'entrepreneur', a term which, along with the 'enterprise culture', has been dominant in political discourse in the 1980s. As argued in Chapter One, the changing nature and increased diversity of self-employment means that this traditional sociological approach is becoming less appropriate (Eardley and Corden, 1996a). What seems to have happened recently is a marked increase of self-employed people whose actual work situation may be far from that of the *petit bourgeois* small business owner.

Most self-employed people in small businesses are sole proprietors, also known as sole traders. It is hard to find overall figures for sole proprietors and partners in business partnerships. A recent internal Inland Revenue compliance cost assessment (Inland Revenue, 1994) was based on records of Schedule D tax assessments. This estimated 2.4 million sole proprietors, and 1.4 million partners in partnerships, with an average 2.3 self-employed partners in each partnership. Not all self-employed people are assessed for tax, however.

Detailed studies of small businesses and people working on their own account have tended to focus on particular groups, for example young self-employed workers (Payne, 1984; MacDonald and Coffield, 1991), small shopkeepers (Bechhofer *et al.*, 1974) building industry workers (Scase and Goffee, 1982), female entrepreneurs (Carter and Cannon, 1988), low-income families (Boden and Corden, 1994; Eardley and Corden 1996a), parents liable for child support (Boden and Corden, 1996) or a group of entrepreneurs in a local area (Rainbird, 1991).

There is no such thing as the 'typical' small business and Eardley and Corden (1996a) point to the wide differences in scale, organisation and activity, even in the low-income sector. It would be hard to compare the way of life of a sheep-farming family with, for example, the routine day-to-day work of a person with an ice-cream round, or that of the skilled clock repairer. The general picture that emerges is that small business, in general, is characterised by high levels of uncertainty. Many proprietors work long hours for relatively little in the way of rewards, despite major commitment and hard work. Many draw extensively on help and unpaid labour from domestic partners, members of the wider family and sometimes friends and neighbours. Although some businesses may recruit employees later on, only a minority expand to large and profitable businesses and most remain formally one-person businesses for as long as they continue in operation. As we shall see in the following chapter, cyclical and unexpected fluctuations in earnings are common, which requires skills in managing cash flows and budgeting, both in business terms and in domestic money management.

It is not helpful here to make further generalisations about the organisation of business and own account working. The literature cited provides a level of detail about specific activities. Among these studies, only Boden and Corden (1994) and Eardley and Corden (1996a) have been primarily concerned with the respondents' situation with regard to social security. It is rare to

find any mention of issues concerning NICs in any of the other studies. They do, however, provide useful accounts of the routes into self-employment, the kinds of activity undertaken, the relative 'success' or 'failure' of the small enterprises, and the aims and aspirations of those involved.

It is useful to look more closely at forms of 'quasi-self-employment', which are likely to explain some of the disproportionate growth in sole trading during the 1980s. The section continues by looking at what is known about subcontracting and franchise work.

Subcontracting

There is considerable academic discussion about whether and how far employers have been strategically effecting changes in their workforces in order to achieve greater flexibility in the market place (see Pollert, 1991; Meager *et al.*, 1992; Dex and McCulloch, 1995). The use of subcontracted self-employed workers features in this debate. The full debate does not concern us here, but there is some evidence from employers (Scase and Goffee, 1982; Wood and Smith, 1988; McGregor and Sproull, 1991) that using subcontracted labour does help them to cope with market uncertainty, and enables them to relinquish employer responsibilities, such as PAYE and National Insurance responsibilities

It is generally agreed that individual subcontracting has increased during the 1980s, but precise figures are hard to obtain. Since 1989 the LFS has asked people who define themselves as self-employed whether they are the owner or manager of the business in which they work: this has been used as an approximate indication of a distinction between 'true' self-employment and labour-only subcontractors (Daly, 1991). In 1989, some 690,000 people said they did not own or manage their business, that is 20 per cent of the self-employed (and more than a quarter of self-employed women). There are some further data on subcontracting in specific industries or occupational groups. A survey of male labour mobility in the construction industry (Marsh *et al.*, 1981) found that 20 per cent of the hireable workforce were self-employed for purposes of tax and National Insurance. Of these, 26 per cent worked directly to the public only; 33 per cent worked directly to the public and for other contractors, and 41 per cent worked only for other contractors. Similar trends have been noticed in the steel industry (Fevre, 1987).

Evidence from representative surveys of employers (Wood and Smith, 1988; McGregor and Sproull, 1991) suggests that, by 1987, 26 per cent of employers were using self-employed workers, including individual subcontractors, and confirmed the high incidence of use of subcontracted work in the construction industry.

The organisational structures within which subcontracted people work can be quite different from those for people running businesses on their own account. In terms of autonomy, control and independence, their circumstances can be more like that of employees (Eardley and Corden, 1996a). Subcontracted workers typically work for an hourly, daily or piece rate. Most of the construction workers studied by Marsh *et al.* (1981) reckoned their earnings in terms of a weekly amount (84 per cent), and only 16 per cent reckoned their earnings as an annual amount. Subcontracted workers are responsible for their own tax and National Insurance contributions. The Inland Revenue has special arrangements for payments of tax by construction workers. Those who have so-called '714 exemption certificates' are paid gross by the body engaging them, but a minority, without such a certificate, expect to have 23 per cent of earnings (ignoring personal tax allowance) deducted for tax from each pay packet. A final tax adjustment at the end of the financial year often means a tax refund for such people. It has been customary for some subcontracted workers paid in this way to use their tax refund to pay the National Insurance liability that had accrued (Corden and Boden, 1996). These findings about money management suggest that it may be more difficult for some subcontracted workers to adapt to the new methods of payment of Class 2 NICs by direct debit or quarterly billing. The Contributions Agency might wish to pursue with Inland Revenue the characteristics of self-employed people for whom tax deductions are made at source of earnings.

Other characteristics of subcontracted workers may be significant in terms of compliance with payments of contributions. Working away from home or moving address in search of work may mean that communication with the Contributions Agency is problematic in some cases. It has been suggested that only a small minority of self-employed construction workers are geographically highly mobile (Marsh *et al.*, 1981). Fieldwork conducted more recently with self-employed fathers living apart from their children found several examples of men, whose

occupations were not known, who moved around the country in the course of their work or went abroad for periods to work (Boden and Corden, 1996). More data is needed about the geographical mobility of the current population of self-employed people.

Periods of unemployment between jobs are part of the usual pattern of working for many subcontracted workers. Attitudes to and experiences of claiming benefits during periods without work may affect views on compliance with Class 2 NICs, and this is discussed further in Chapter Seven.

Franchising

Franchising is a relationship between larger firms/employers and self-employed people that has also expanded during the 1980s. Product or trademark franchises have been familiar for several decades, for example those that are sometimes called 'first generation' franchises such as 'tied' public houses, and petrol stations operated independently in association with oil companies (Felstead, 1991a). It is the business format franchises, the 'second generation', which have seen most recent growth. Here, the franchisee sells the franchiser's product or service in accordance with their procedures or format. The franchisee provides most of the capital outlay, and pays a licence fee and some continuing royalties, such as percentage of turnover. The franchiser provides assistance, such as training and customer bases and may effect agreements to restrict competition from other franchisees. Nevertheless, there is substantial transfer of business risk to the franchisee. Many businesses now operate and offer franchises on such bases. The trademarks of the major operations are household names (for example, Pizza Hut, Tandy, Dyno-rod, Cornerstone). Large franchises like these are likely to be operated through limited companies, but some franchisees are self-employed, for example many milk rounds are small franchises operated through large dairies and retail food suppliers.

Although there has been considerable expansion, the numbers of people engaged in franchise operations represent a very small proportion of the total number of self-employed people. Felstead (1991b) suggests that there were some 17,000 franchised outlets in the UK at the end of the 1980s, and Meager *et al.* (1992) point out that, on the assumption that each outlet has, on average, two self-employed people, and none existed previously, only about 0.2 per cent of growth of self-employment during the 1980s might be attributed to franchising.

Felstead (1991b) discusses the social organisation of the franchise. He argues that the indirect control mechanisms operated by the franchiser act to maintain their economic primacy, despite the investment made by the franchisee. The franchisee shares profits if turnover increases, but bears the greater risk should the business make a loss. They have restricted rights to the business assets. It is common for franchisees to work long hours, and many rely on family labour. Felstead (1991b) suggests that 'controlled self-employment' is a more appropriate description of this way of working.

Eardley and Corden (1996a) describe the business arrangements of a franchisee in the retail food industry. In the early years of operation, costs imposed by the franchiser reduce substantially the profitability of the enterprise. In addition, the business transactions can be complex, and hard to demonstrate for purposes of, for example, income-related benefits. Further evidence that franchisees (and self-employed agents) have problems demonstrating earnings for administrative purposes comes from interviews with parents who have dealt with the Child Support Agency (Boden and Corden, 1996). We do not know whether experiences of this kind affect attitudes to compliance with paying contributions.

National trends in the development of franchising can be followed through the national surveys conducted on behalf of the British Franchise Association and sponsored by the National Westminster Bank (NatWest/BFA, 1996), and an annual directory of members of the British Franchise Association (1996) is available commercially. These may be useful to the Contributions Agency, which may also be interested to attend the 'franchise fairs' which are held in various venues as a major means of communication and development within this sector of business.

Homeworkers, outworkers, 'freelance' workers

There is a substantial research literature devoted to people who are identified either by themselves or by employers as homeworkers, outworkers, or freelance workers. There are no clear definitions for these terms, and there is overlap with groups previously described. One homeworker may be working as a subcontractor, for example, while another considers herself running her own business. Some homeworkers are employees. Homeworking is, in fact, the oldest form of industrial working. Hakim (1984) suggests that the terms homeworker and outworker are well established in the manufacturing sector, but a wider range of terms are used

in the service sector for people who work at home or off-site, including freelancers. More recently, the term 'teleworker' has been introduced to describe those people working from home using new technology.

Data from the Labour Force Survey, presented in Table 4.1, shows that in Great Britain in autumn 1994 there were 664,000 men and women working in their own home.

Table 4.1: People working at home in main job by industry and occupation, Great Britain, autumn 1994

	<i>Thousands</i>		
	all	men	women
Paid employees and self-employed working in own home	664	212	452
Industry			
manufacturing	85	20	65
non-manufacturing	577	191	386
Occupation			
Managers and administrators	152	68	84
Professional	76	44	32
Associate professional and technical	110	51	58
Clerical and secretarial	135	*	130
Craft and related	49	19	30
Plant and machine operators	21	*	18
Other	118	20	98
Who they work for			
an outside organisation	124	39	85
on their own account	330	127	203
a family business	185	38	148

* less than 10,000 in cell

Source: LFS, autumn 1994

Table 4.1 is taken from *Employment Gazette*, May 1995, Helpline, Table 2, and included with the agreement of the Office for National Statistics

Table 4.1 shows that the majority of people working at home were concentrated in the non-manufacturing industries. The majority were self-employed or worked in a family business. Greater London had the highest proportions of homeworkers, and homeworking rates in general were higher in the south of England than in the rest of Great Britain.

A number of reasons have been suggested for the predominance of women homeworkers (Cragg and Dawson, 1981; Allen and Wolkowitz, 1987). These include that this is a form of work which can be undertaken by women who have dependent children, those in poor health, those who are excluded from the workplace by language or cultural barriers, those who have caring responsibilities for elderly relatives, or that the kind of work undertaken fits traditional women's activities, such as cooking and sewing. Allen *et al.* (1992) argue that understanding the interdependence of different kinds of women's work activities, paid and unpaid, is essential in considering home-based economic activities. Gender specific responsibilities for childcare and housework may be important in distinguishing men's and women's paid work in the home. A large proportion of women homeworkers are from ethnic minorities (Huws, 1994b).

The need for extra money is also an important reason for many women to undertake work at home (Huws, 1994b). Research has shown that for many women, working at home brings only low pay, and disadvantages such as isolation and health problems (Cragg and Dawson, 1981). However, Phizacklea and Wolkowitz (1995), bringing together what is known about homeworking, make the important point that different methodologies locate different kinds of homeworkers. They describe five groups, characterised by different degrees of remuneration, autonomy, security of earnings and employment. Included here are so-called 'casualised employees' in a wide range of types of work, including manual workers in the clothing industry and clerical workers, both often defined as self-employed but with low pay and minimal control. Micro-entrepreneurs include such people as bed and breakfast proprietors or craft workers. Self-employed professionals, such as teachers, people engaged in text processing, or accountants, may command high earnings. Very small businesses such as mail order distribution may also generate relatively good earnings, and some of these are incorporated businesses. Finally, technical and executive level employees may also work at home, including so-called 'teleworkers'.

A recent telephone survey of 1,000 employers in 1992-93 found that 11 per cent were using some form of home-based employment, and half of these were using 'teleworkers' (Huws, 1993, 1994a). The occupations in which the numbers of teleworkers were greatest are for women, data entry, secretarial work, translation and research, and writing, editing, journalism and translation for men. Teleworkers were most likely to be self-employed among the occupational groups of data entry, secretarial and administrative work, research and translation, while employee status was more frequently found among managers and professional staff, those most likely to be employed in small numbers.

So far we have talked about self-employed people as individual workers, but some choose to share the risks and rewards of work by working in partnership with others, and we go on to consider what this means.

Partnerships

The Partnership Act 1890 defines a partnership as the 'relation which subsists between persons carrying on a business in common with a view to profit'. The relationship involves a contract between the people concerned, who may variously contribute property, skills or labour, or none of these if they are 'sleeping' or 'dormant' partners. It is the sharing of the risks and rewards which distinguishes a partnership from the employer/employee relationship, where the risks are not shared. Under the same Act, partners may be assumed to have an equal share unless there is a formal or informal agreement otherwise.

Partnerships are more likely to be found among people working in the small business sector or on their own account. As businesses grow, they tend to incorporate in order to attract capital and limit risk. Lawyers and solicitors, by law, cannot form limited liability companies, and as a result there are a number of large partnerships in this occupation group, with substantial business turnover. It is possible for people to work in partnership as subcontractors, or as franchisees. Labour Force Survey data do not reveal directly self-employed people's status regarding their business partnership with others. Business partnership has not been a main focus of interest in much of the sociological literature about the development of small enterprise and 'entrepreneurship'. There is some information available about the way in which spouses work together in business enterprises, but less is known about the development of business partnerships

among non-related people. There is little quantitative data about the characteristics of self-employed people working in business partnerships. Small-scale studies illustrate the kinds of arrangements that exist. For example, Carter and Cannon's (1988) study of female entrepreneurs found that when partnerships were run in conjunction with men, these were either husbands or domestic partners, usually brought into the business after a successful female start-up period. When the business partners were women, these were usually people in similar situations or stages in the life cycle. Eardley and Corden's (1996) study of low-income self-employment includes detailed descriptions of partnership arrangements, most of which were between spouses or relatives.

As explained above, under the Partnership Act 1890, partners may be assumed to have an equal share unless there is a formal or informal agreement otherwise. Partners have separate liability for NICs on the share of profits allocated to them. In all business partnerships there is the possibility of allocating income in such a manner as to maximise the advantage of one or more of the partners in some way. Common-sense accounting assumptions and professional experience suggests that this is most likely to happen within families or between domestic partners, because there is less risk of losing control of the income. Accountants regularly advise couples where one or both work as self-employed about the 'best way' of describing the organisation of their work, to maximise their financial position in regard to tax, National Insurance liability (for example, see *Accountancy*, 1993) and, recently, child support liabilities (Boden and Corden, 1996). An alternative to a business partnership arrangement between domestic partners is for one spouse to be described as a formal employee, which might be appropriate in a business generating very low earnings, for example. The 'employee's wages' are then counted as expenses, but if set low, are not liable for NICs.

As a result of these financial implications, there is variation in the extent to which 'business partnerships' actually reflect input of work and real access and control of earnings on the part of the individuals concerned. Other factors which may have a bearing on this are partners' personal characteristics and the history of the business. For example, older people may remain family business partners beyond the stage of much participation or interest in the work, and expect little transfer of profits (see examples in Eardley and Corden, 1996a; Boden and Corden, 1996). We do not know whether such factors affect compliance with Class 2 NICs. There might be an

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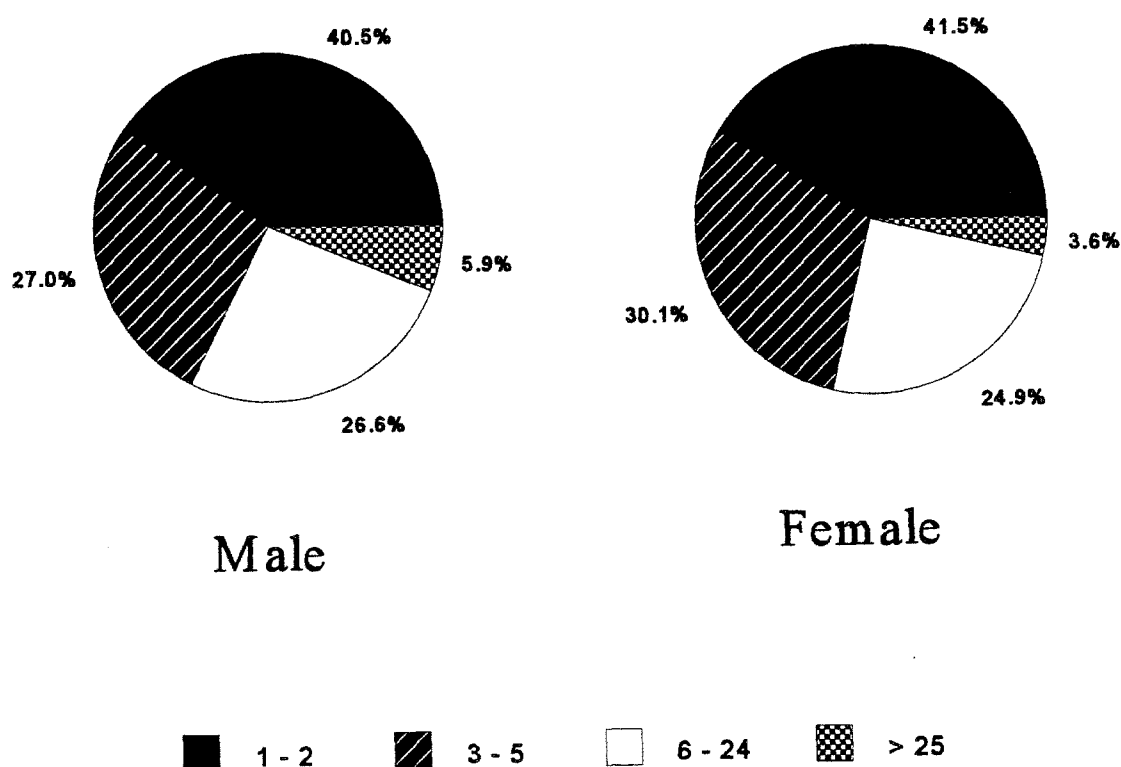
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is now easier and cheaper to incorporate businesses, and some self-employed business owners with small workforces may have chosen this route, thus becoming employees themselves.

More recent analysis of the LFS, spring 1994, by Dex and McCulloch (1995) suggest that the proportion of self-employed people with employees is continuing to decline. They found 26 per cent of self-employed men and 25 per cent of self-employed women had employees.

Figure 4.1: Self-employed people with employees, showing number of employees, Great Britain, 1991



Source: Campbell and Daly (1992) p285

Figure 4.1 included with agreement of Office for National Statistics

Figure 4.1 was compiled by Campbell and Daly (1992) using data from the 1991 Labour Force Survey. As can be seen, both men and women employers have, in general, small numbers of employees. Nearly half of the self-employed with formal employees employ only one or two others, and only about a quarter have more than five employees. The numbers of self-employed

people who employ more than 25 people are very low indeed. As might be expected, self-employed people with employees are likely to be older than those who work on their own. They are also more likely to be married (Curran and Burrows, 1989) and tend to be more highly qualified, in terms of educational attainments. There are variations by industry in proportions of self-employed people who employ others. Thus, in 1991, nearly half of all self-employed people working in distribution, hotels and repairs had employees, while only 17 per cent of those in construction were employers. A full analysis of the industrial distribution of self-employed people who are employers is presented by Campbell and Daly (1992). More recent analyses of the LFS, spring 1994, presented by Dex and McCulloch (1995), distinguish self-employed people with and without employees, throughout. These analyses can be used to compare self-employed people with and without employees, in respect of characteristics such as age, marital status, dependent children and ethnic origin.

Rubery *et al.* (1993) have suggested that the self-employed without employees tend to be furthest from the traditional sociological model of own account working, with ownership of means of production, and autonomy and control. Their study of self-employed people in six selected labour markets showed self-employed people without employees to be more likely to work from or at home, to work for one 'employer' only, and to be paid by hours worked. Stanworth and Stanworth (1995) looked closely at the working arrangements of a group of self-employed editors, proof-readers and indexers in the UK book-publishing industry and concluded that they were essentially more like casualised employees. Stanworth and Stanworth emphasise that there are many self-employed people without employees who are not progressing through an early stage of business growth, and are neither aiming towards nor likely to achieve a small business with a workforce.

However, it is possible that statistical analyses of self-employed people's use of employees does not give a full picture of the extent to which they draw on other people's labour. Qualitative studies confirm that self-employed people often draw extensively on other labour (Rainbird, 1991; Eardley and Corden, 1996a) even when they appear to work on their own. Farmers, hoteliers, and retailers described their use of casual or subcontracted labour to meet seasonal demands of work-flow, but such people are not always formal 'employees'. Much of the employment offered by self-employed people is itself in the 'non-standard' sector of part-time, temporary or casual, or self-employed work. It is hard, however, to estimate how many self-

employed people are themselves subcontracting work from other self-employed workers. The previous section gave a picture of employers' use of homeworkers, outworkers and freelance workers, but we do not know how many of such 'employers' are self-employed people. The Inland Revenue PAYE audit investigation teams seek information from both incorporated and unincorporated employers and the Contributions Agency might discuss with the Inland Revenue ways of monitoring the use of labour by self-employed people, to identify people with Class 2 liabilities.

There are indications that the use of non-employee workers may be very significant in UK small firms. (There is no single definition of 'a firm'; the term tends to be preferred by economists to 'a business', but may be used interchangeably.) Storey (1994) refers to work conducted by Scott *et al.* (1989) who examined firms in four sectors: traditional manufacturing, traditional services, high-technology manufacturing and high-technology services. Overall, one-third were using non-employee workers. The importance of family involvement was emphasised, and Storey confirmed that there is considerable informal employment in the small firm sector. Within this informal employment, some of the arrangements were considered irregular. One-third of the hotels studied, for example, were considered to be 'employing labour at the margins of legality' (Storey, 1994, p177). In all these cases, some form of evasion, either of tax or National Insurance, was indicated, for reasons of cost cutting. Money was saved by paying people 'cash in hand' or taking them 'off the cards'. We do not know how many of the firms which Scott *et al.* (1989) described had proprietors who were currently self-employed. What is important is the suggestion that the practice of use of non-employee workers is widespread in the small business world.

The Contributions Agency is already in touch with many small firms, in respect of employer National Insurance liabilities for formal employees. This enables opportunities to look at administrative and contractual records which provide information about some 'non-employee' labour. The data on the geographical and industrial distribution of small firms may suggest where it might be useful to intensify such efforts.

It is important to emphasise here, however, that there is not a strong body of evidence that demonstrates how far self-employed people use 'irregular employment'. As Rainbird (1991) points out, there may be opportunities for self-employed people and small business owners to

supplement income through evasion and cash payments to workers; and such opportunities may seem attractive, but practices of this kind can weaken their economic position in the long run. Non-payment and bad debt are major problems for small businesses, especially in the construction industry, and if there are no formal records of work undertaken or what has been agreed, the business cannot claim redress. If self-employed people pay wages 'cash in hand' they may be deterred from showing these expenses because of the risks of detection, and the subsequent overstatement of earnings may rebound to their disadvantage. Boden and Corden (1996) interviewed a sub-contracted construction worker who explained that although he paid his young assistant 'cash in hand' he did this with reluctance. His tax bill and Child Support liability were inflated as a result, and he would have much preferred a formal arrangement. The kind of labour he sought was in short supply, and set terms of engagement to which he felt he had to agree.

We do not know whether self-employed people's own patterns of labour use and payments for work done affect their compliance with paying their own National Insurance contributions, and this might be investigated.

It is also important to emphasise that although many small businesses and self-employed forms of work draw heavily on labour within the family (Eardley and Corden, 1996a; Wheelock, 1992; Rubery *et al.*, 1993; Felstead, 1991b) it must not be assumed that this is 'irregular work'. People participate in a variety of 'family undertakings' without formal arrangements or exchanges of money in recognition of work contributed. Unless some form of payments have been made, there are no earnings on which there are Class 2 liabilities.

People who work as self-employed and employees

Analyses using LFS data of the numbers and characteristics of self-employed people do not include those people whose main job is as an employee, but have a second job as a self-employed person. Such people may be liable for Class 2 NICs in addition to Class 1 NICs (up to an annual maximum which is close to the amount paid at the upper earnings limit). Campbell and Daly (1992) looked separately at this group - those involved in self-employment but not counted in the usual total. Numbers have increased substantially since 1981, and by 1991 there were 135,000 men and 101,000 women, a total of 236,000 such people. Put another way, one employee in a hundred may have a second job as a self-employed person. The same analysis

suggests that there may be two in a hundred self-employed people who also work as employees in a secondary occupation. No further characteristics of such people are described by Campbell and Daly, but the Contributions Agency may wish to pursue further analyses here. The balance of earnings between self-employment and work as an employee might affect people's perceptions of insurance liability, or their inclinations to pay different kinds of contributions. The following chapter looks more closely at the incomes of those people with earnings from a number of sources.

Conclusions

This chapter has considered the various kinds of sole proprietorships and partnerships in unincorporated businesses, and emphasised the extreme heterogeneity of self-employment. The lack of a satisfactory classification of different forms of self-employment, and overlaps between the terms used means that it is hard to find reliable estimates of numbers of people working in the forms identified.

However, considerable numbers of people are working in forms of work which are far from the traditional concepts of 'business' or 'working on one's own account'. Those people working at home, many of whom do not have a 'business address', may represent a target group of some importance to the Contributions Agency. Approximately half can be expected to be self-employed. The research literature confirms the importance of the Agency's efforts to identify self-employed people via firms and businesses. It also seems likely that statistical data about the use of employees by self-employed people do not properly represent the extent to which some self-employed people rely on temporary, casual, part-time or 'one-off' workers, many of whom will themselves be self-employed. It is harder for the Agency to identify this type of contract.

There is evidence of considerable input into some kinds of self-employed work by family members - spouses, children, and other relatives. However, it must not be assumed that there are National Insurance liabilities for the people involved. This is a difficult area, and there is often a poor fit between the way in which people work in 'family undertakings' and regulatory systems, including National Insurance.

CHAPTER FIVE

THE INCOMES AND LIVING STANDARDS OF SELF-EMPLOYED PEOPLE

The characteristics of self-employed people discussed so far suggest that a considerable number may have only modest earnings from such work. This chapter looks in detail at the incomes and living standards of self-employed people. The significant problems in measuring earnings from self-employment are addressed first. The second section describes what is generally known about the distribution of incomes from self-employment, from previous research, looking first at individual earnings of self-employed people. Inland Revenue statistics on individual earnings offer a useful perspective for the Contributions Agency. Alongside the distribution of self-employed earnings, we consider income from other sources, including earnings from employment, as the overall level of all earned income of individuals is of interest in the context of non-compliance. While people are liable for Class 2 NICs on the basis of individual earnings, budgeting strategies may be influenced by household incomes. The third section looks at incomes of households with a self-employed head. The chapter ends by looking at some aspects of the living standards of self-employed people.

Measuring self-employed earnings

It is generally recognised that there are a number of problems in measuring self-employed earnings. These may affect a person's own assessment of their earnings (and that of their advisers, such as accountants), how those earnings are reported to a regulatory authority (such as the Contributions Agency) or a survey interviewer, and the way in which the financial data reported are then dealt with. There is no precise scientific measure of income derived from trade or business. The measurement of such income is properly an accounting exercise, and accountancy is an art which is practised at different levels by people with different interests and expertise.

The problems of measuring low incomes from self-employment, in the context of measuring entitlement to social security benefits, have been addressed by one of the authors elsewhere (Boden and Corden, 1994). The problems have also been pursued in the context of the collection and analysis of statistical data on self-employed earnings (Eardley and Corden, 1996b), and

detailed explanations and arguments may be followed in those publications. For the purposes of this review, we summarise the main problems. However, the detailed explanations and illustrations in the two volumes cited (both of which are based on research commissioned by the Department of Social Security) are likely to be useful to the Contributions Agency.

The problems generally identified in the measurement of self-employed earnings using survey-based data include the following:

- *the definition of self-employment*

Problems in defining self-employment were discussed in Chapter One. What is measured as earnings from self-employment (or not) depends on what is identified as 'self-employed work' by the survey respondents, the researcher, the interviewer and the data analyst.

- *under-reporting of income*

The assumption that self-employed people understate their incomes is widespread, leading some researchers to ignore income data in favour of other indicators such as household possessions (Curran and Burrows, 1989). There may, however, not be a direct relationship between current earnings and levels of consumption or ownership (Eardley and Corden, 1996a). Doubts about the accuracy of reported incomes are reinforced by problems such as the relatively low response from self-employed people achieved in household surveys.

- *differential response rates*

Low response by self-employed people has always been a problem in using household data sets. Meager *et al.* (1994) found that 44 per cent of self-employed respondents failed to supply income data, compared with 13 per cent of employees, in the first wave of the British Household Panel Study. Some respondents just do not know the answer to interviewers' questions about financial matters, while some may not wish to provide information (Eardley and Corden, 1996b).

- *time-lags*

In the FES earnings figures from self-employed people are acceptable from any business year ending during the 12 months prior to interview. Thus the periods of time to which earnings data relate vary considerably. The longer the time-lags, the greater the uncertainty that the figures reflect the respondent's current financial position, and there are corresponding problems of comparison with employees' earnings. There are a variety of ways of trying to update self-employed earnings, but there are particular problems in dealing with reported business losses.

- *concepts of 'earnings' and measurement of profit*

Accounting methods are socially constructed and reflect the context in which they are to be used. A wide variety of methods of measurement of earnings is of use in the UK. What is measured in a survey questionnaire reflects merely the nature of the information requested and the technical rules constructed by the analyst to deal with the data provided. Without examination by people with accountancy skills, and incorporation of other material such as balance sheets, the analyst is unlikely to achieve consistent, comparable income measures across a range of self-employed businesses and incomes.

- *use of 'drawings' as a proxy for profits*

When nil profits or losses are reported in the FES or respondents cannot provide profit figures, drawings have been used as a proxy; but without corresponding data on debt or run-down of savings, there are problems in adopting this approach (Eardley and Corden, 1996b).

- *derivation of profit by accountancy techniques*

Data from professionally produced profit and loss accounts, using traditional rules of commercial accounting, are likely to reflect a variety of approaches and treatments. For example, items to be allowed as expenses may be a matter of professional judgement, and the figures construed in the profit and loss account may be affected by judgements about eventual tax liability.

These technical difficulties do not mean, of course, that income data from household surveys is not worth using. Recognition and discussion of the problems will lead to improvement of research methodologies, and more critical understanding of survey findings. New questions have been piloted and introduced in the FES and FRS from April 1996, in order to collect income data of a higher standard from self-employed people (Martin *et al.*, 1996).

What is important for the Contributions Agency is recognition that there exists no 'real measure' of self-employed earnings; that there are limitations in the use of income data from household surveys for this group, and that what has previously been assumed to be purposeful misrepresentation of profitability of a business may, in fact, just reflect the particular accounting techniques and measures used by those involved. It may be useful for the Contributions Agency to compare the technical measures of income that are accepted or imposed in assessment of liability for contributions with other measures of self-employed income used by the Department of Social Security (for example, for assessing entitlement to income-related benefits) and in assessing liability for child support. Inconsistencies might well contribute to non-compliance or non-take-up in a number of areas.

With the above provisos, the next section looks at what is known about the distribution of income among self-employed people.

Distribution of income of self-employed people

Liability of individuals for NICs depends on personal income from self-employment and employment. Eardley and Corden (1996b) have undertaken a detailed review of the available information on the income and earnings of self-employed people from sources such as the GHS in Curran *et al.* (1987); the Social Change and Economic Life study (Rubery *et al.*, 1993) and the BHPS in Meager *et al.* (1994), and present some original analyses of the FES. They claim that the cumulative evidence is remarkably consistent from all these sources, with income from self-employment being more widely dispersed than that from employment, with higher proportions of the self-employed than employees appearing at both ends of the income scale, that is with very high or very low incomes. In this section we present some more detailed and recent information on the income of self-employed people, first at the level of individual earnings from self-employment, and then for households where the head of the household is self-employed.

Individual earnings

The regular published reports from the FES, GHS or LFS do not contain information about the earnings from self-employment of individuals. The most recent detailed comparisons of individual earnings ('labour incomes') of employees and self-employed people based on a household survey are those conducted by Meager *et al.* (1994). These comparisons are presented on the basis of net earnings, rather than gross. The Contributions Agency may be interested in comparisons of gross earnings, since it is gross earnings from which NICs are paid. Further secondary analysis of national data sets might be conducted for this purpose.

In the meantime, the analysis by Meager *et al.* (1994) helps to locate self-employed earnings within the general earnings distribution. Meager *et al.* analysed the first wave of the British Household Panel Study carried out in 1991, separating the self-employed into those with and without employees, and comparing them with employees. Table 5.1 is derived from their results. It shows various statistical measures to describe the incomes from work of self-employed and employed workers, and a brief explanation of these measures is useful. The mean income is the commonly understood average income. The median is the income which divides the sample in two, one half with lower, and one half with higher incomes. It is not so affected by very high or very low values as the mean. The mean and the median are measures which indicate the average or middle value of the incomes from work of self-employed and employed people. Also of interest is whether most of the incomes are close to the median or mean or whether they are widely spread. The coefficient of variation is one way of measuring the spread. This is defined as the standard deviation as a percentage of the arithmetic mean and is a common measure of the variability in a distribution. The lowest quartile value marks the income below which a quarter of the sample is located, and the highest quartile has a similar position at the upper end of the distribution. Like the median these quartile measures are unaffected by very high or very low values of income. Ten per cent of the sample have income lower than the income which marks the bottom decile, and ten per cent have incomes higher than the top decile. The ratio of the incomes marking the top and bottom decile provides another measure of the spread of the incomes.

Table 5.1 shows that the mean monthly net labour income of self-employed people (£869.1) was greater than that (£714.7) for employees. As we will see below, this is partly a result of some

self-employed workers having very high earnings. The mean earnings of self-employed women were not, however, greater than those of female employees. The median incomes of the self-employed were lower than those for employees, looking separately at men and women. The median income of all self-employed people is higher than that for employees, however, because of the greater proportions of men among the self-employed.

The lower mean household income of households headed by a self-employed earner compared with households headed by an employee noted by Eardley and Corden (1996b) for 1991 contrasts with these findings of Meager *et al.* (1994) of higher mean net labour incomes of self-employed people compared with employed individuals. This is because there is not a one-to-one relationship between the income of the head of the household and total household income; the number of workers or the age-structure in the households may differ.

Table 5.1: Usual monthly net labour income for self-employed people and employees by gender, Great Britain, 1991

	<i>Mean</i>	<i>Coefficient of variation¹</i>	<i>Median</i>	<i>Lowest quartile</i>	<i>Highest quartile</i>	<i>Top/ bottom decile</i>	<i>No. of cases</i>
	£	£	£	£	£	£	
All							
Self-employed	869.1	1.02	652.0	312.1	1093.9	12.55	441
Employee	714.7	1.02	632.0	398.0	921.6	6.56	4,566
Men							
Self-employed	991.2	0.92	744.0	486.7	1214.4	7.70	340
Employees	906.6	1.00	810.0	600.0	1100.0	3.41	2,358
Women							
Self-employed	459.6	1.36	243.0	123.7	505.9	26.41	101
Employees	509.6	0.71	450.0	263.7	666.3	6.54	2,208

Source: BHPS 1991 in Meager *et al.* (1994)

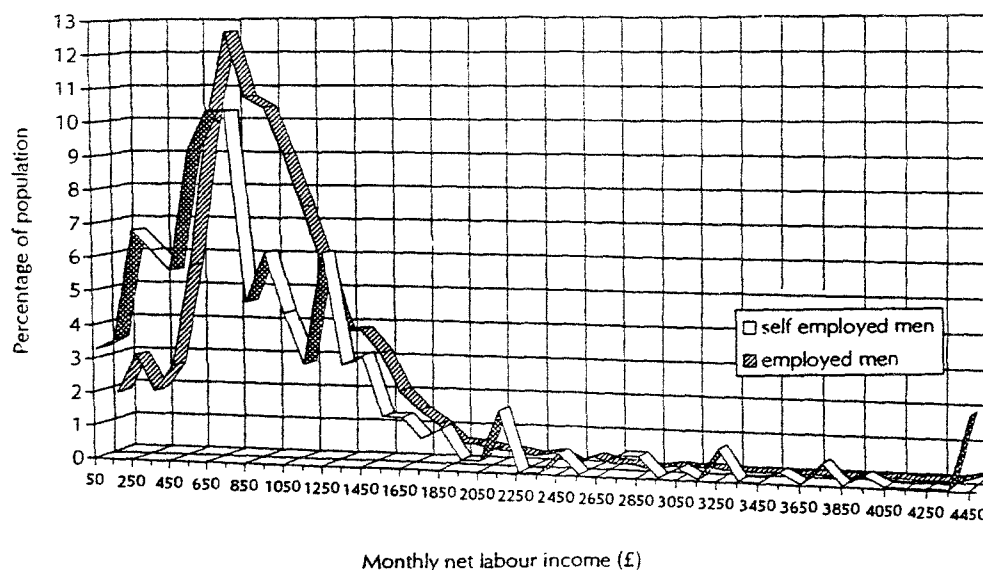
¹ The coefficient of variation is defined as the standard deviation as a percentage of the arithmetic mean.

Table 5.1 shows that the coefficients of variation for the net labour incomes of all self-employed people and all employees were similar - so the spread of income values for both groups was similar according to this measure. However, for men, the coefficient of variation was lower for the self-employed than for employees, and the reverse was true for women. Self-employed women had considerably more variable net labour incomes than female employees. The coefficient of variation, as a measure of the inequality in a distribution, is affected by high and low income values, and among the self-employed there were some people with very high incomes.

Table 5.1 shows that a quarter of all self-employed people had net labour incomes below £312.1 whereas a quarter of employees had incomes below £398.0, so that there was a group of self-employed people with considerably lower incomes than employees. Conversely, a quarter of self-employed people had net labour incomes greater than £1,093.9 whereas the top quarter of employees had incomes greater than £921.6. This increased dispersion of net labour income is illustrated more dramatically by the ratio of the top to the bottom decile - that is the ratio of the values above and below which ten per cent of people have incomes. The ratio for the self-employed was 12.55 compared with 6.56 for employees.

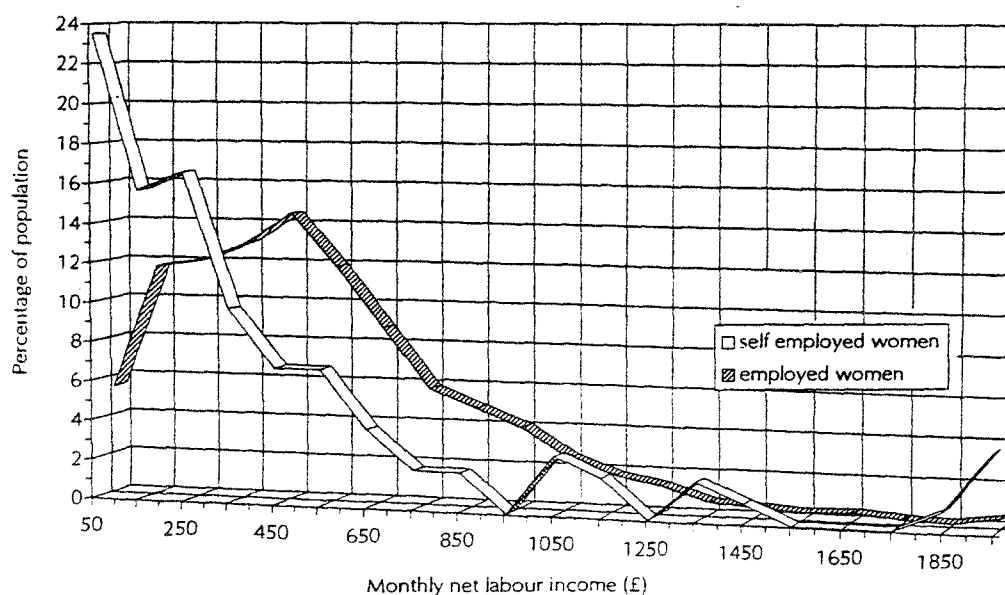
The difference between the self-employed and employees is particularly striking for women. Self-employed women seem to have a particularly unequal distribution of net labour income from self-employment. Meager *et al.* (1994) note that more than a fifth of women earned less than £100 per month, and the shape of the distribution was very different from that for men. Few self-employed men earned very little per month and the majority earned within the range £250 to £1,250 per month with a peak at £650, and a long tail of men earning high incomes as shown in Figure 5.1. The distribution of women's income curves downwards from the lowest income range (£0-100) as shown in Figure 5.2.

Figure 5.1: Monthly net labour income distribution of employees and the self-employed - men



Source: Meager, N., Court, G. and Moralee, J. (1994) p.48, Table 3.2, based on data from BHPS 1991 (weighted data)

Figure 5.2: Monthly net labour income distribution of employees and the self-employed - women



Source: Meager, N., Court, G. and Moralee, J. (1994) p.48, Table 3.3, based on data from BHPS 1991 (weighted data)

Further evidence of the unequal distribution of self-employed labour income was demonstrated by Meager *et al.* (1994) in the proportions of self-employed in the bottom and the top of the overall labour income distribution. Overall, 8.8 per cent of the sample identified themselves as self-employed, but in the lowest quartile 10.6 per cent of people were self-employed and in the highest, 10.7 per cent; the proportions in the lowest and highest decile are even higher. This pattern of higher proportions in the extremes of the distribution was present for both men and women. In these comparisons it should be noted that the response on income data was 56 per cent for self-employed people compared with 87 per cent for employees.

The main message to be taken from these investigations of the net labour incomes of self-employed people is that incomes from self-employment are more variable than those from employment. Self-employed people are more likely to have very low earnings than employees; they are also more likely to have very high earnings. The heterogeneity of self-employment has been mentioned earlier and is reflected in the incomes received as a result of these widely differing activities. This suggests that a wide variety of approaches may be required to achieve compliance in paying National Insurance from those with such diverse backgrounds and incomes.

Another way of comparing earnings is to look at hourly earnings. Men's hourly gross earnings from self-employment in 1992 are compared for people of different age groups by Dex and McCulloch (1995). They show that for men in most age groups except those aged 30-39 years, full-time permanent employees had higher mean hourly earnings than self-employed people without employees. Conversely, younger self-employed men with employees earned considerably more per hour than full-time permanent employees. At age 20-29 years, self-employed men with employees earned £11.02 per hour and at age 30-39 years they earned £12.40 per hour whereas in the same age groups full-time male permanent employees earned £6.36 and £8.91 per hour, respectively. However in the 40-49 year age group, self-employed men, even those with employees, earned less on an hourly basis than their contemporaries who were in full-time permanent employment. This may be a result of the career structures often built in to full-time permanent employment, particularly for men. Numbers are small for making similar comparisons for women, but it is possible to compare full-time permanently employed women, aged 30-39 and 40-49 years, with self-employed women without employees. In both age groups self-employed women without employees earned less per hour.

The comparison of the gross hourly earnings from self-employment with those of full-time permanent employees shows that in the majority of cases (those without employees) the earnings from self-employment were lower than employees. This and the greater fluctuation over time likely in self-employed incomes may have an impact on the budgeting of self-employed people and their ability to meet relatively large expenditures. (Although Class 2 contributions for the self-employed are lower than Class 1 contributions for employees, quarterly bills may seem relatively large expenditures.)

Some information on individual gross incomes from self-employment is given by the analysis of the survey of personal incomes published annually by the Inland Revenue (Inland Revenue Statistics, 1995). It covers only those individuals for whom the Inland Revenue hold records. There may be no record if income is below the tax threshold. Tax-evading individuals also may not be recorded at all, or may be recorded as having lower incomes than is in fact the case. PAYE was payable on incomes of £3,445 and over in 1993-94: the lower earnings limit for Class 1 contributions was £56 per week (or £2,912 on an annual basis) and Certificates of Exception for Class 2 NICs were granted on the grounds of income below £3,140. The self-employed tables only include individuals with profits which are assessable, or with losses allowed against other 1993-94 incomes.

Table 5.2: Self-employment income assessable to tax, 1993-94

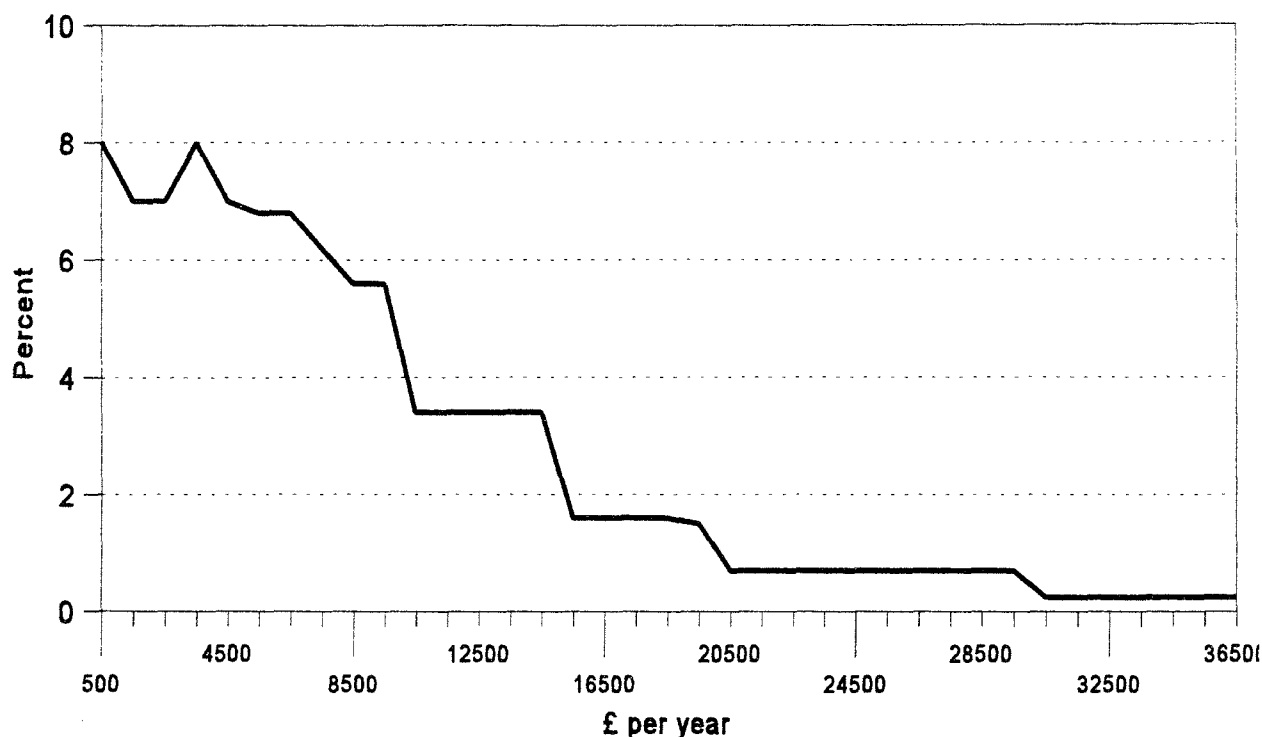
<i>Range of self-employment income (lower limit)*</i>	<i>All</i>	<i>Agriculture</i>	<i>Manufacturing</i>	<i>Construction</i>	<i>Wholesale, retail, repairs, hotels and restaurants</i>	<i>Transport</i>	<i>Financial, renting and business services</i>	<i>Other</i>
	%	%	%	%	%	%	%	%
£								
Negative ¹	1	2	<1	<1	<1	2	1	1
0 ¹	1	4	1	<1	1	1	1	5
1 ¹	3	4	5	1	2	3	5	6
500	3	3	4	2	2	2	4	4
1,000	7	8	6	4	7	7	7	9
2,000	7	7	8	6	6	4	6	8
<i>All below 3,000</i>	<i>22</i>	<i>28</i>	<i>24</i>	<i>13</i>	<i>18</i>	<i>19</i>	<i>24</i>	<i>33</i>
3,000	8	8	6	5	9	4	5	9
4,000	7	7	6	5	7	6	5	6
5,000	17	14	14	20	16	21	12	13
7,500	14	12	13	19	12	15	9	8
10,000	17	15	16	23	16	16	11	10
15,000	8	8	7	9	8	8	8	5
20,000	7	6	9	4	7	6	10	4
30,000	5	3	3	2	3	3	8	6
50,000	3	1	1	<1	1	1	8	4
Number of incomes (thousands)	3,470	319	224	1,020	803	179	552	729

Source: Inland Revenue Statistics, 1995

¹ Boundaries as reported in published tables

* The class indicated by £500 includes those with income of £500 or over but less than £1000.

Figure 5.3: Distribution of income from self-employment, 1993-94



Source: Inland Revenue Statistics, 1995

Table 5.2 presents Inland Revenue data and Figure 5.3 draws on data in the first column of Table 5.2 to show the distribution of income from self employment. We see that the majority of these self-employed people had gross income from self-employment in the income range from £5,000 to £15,000 per annum. Some people had negative incomes from self-employment, for example those with a reported business loss. Some had very low self-employed incomes - 22 per cent had earnings from self-employment lower than £3,000, and might be among those who could apply for a Certificate of Exception for the payment of Class 2 NICs. For some people this amount of self-employed income could be a supplement to a main job as an employee, for which they might pay a Class 1 NIC. For others, however, this low income will represent their only earnings, for example those whose businesses are only modest enterprises, or in decline. Eardley and Corden (1996a) describe in detail the lives of low-earning self-employed families with children. It is interesting here to compare a table derived from secondary analysis of the individual data from the 1990-91 FES (Eardley and Corden, 1996b, Table 3.2, p.11), showing the proportions of self-employed people with earnings below the

tax and Class 2 NICs thresholds. There, 21.8 per cent of all self-employed people had earnings from self-employment below the Class 2 NICs threshold. Women were much more likely than men to have earnings below this threshold, 50.1 per cent compared with 12.7 per cent respectively.

In 1993-94 Class 4 contributions were payable on self-employed earnings over £6,340. From Table 5.2 we estimate that 64 per cent of those with self-employed income had self-employed earnings greater than £6,000, by noting that 54 per cent had incomes from self-employment more than £7,500, and extrapolating the numbers earning more than £6,000 in the interval £5,000-7,500. Using a similar technique we estimate that seven per cent had earnings from self-employment of £22,000 and over, in which range Class 4 contributions were payable at a flat rate.

Table 5.2 also shows the proportions of self-employed people in different industries with different levels of earnings from self-employment. Those working in the 'other' category, in agriculture, and, to a lesser extent, in the financial, renting and business services sector, and in manufacturing, were more likely than average to be earning less than £3,000 gross per annum from self-employment. The likelihood of earning more than £3,000 from self-employment was noticeably greater for those in the construction industry. By contrast, this group was the least likely to be earning more than £20,000 per year from self-employment, six per cent compared with 15 per cent of all self-employed people, and 26 per cent of those working in the financial, renting and business sector. Those working in the construction sector, almost a quarter of all self-employed people, had a fairly narrow range of income from self-employment, with 62 per cent of them earning between £5,000 and £15,000 per year.

Table 5.3: Sources of income for those with income from self-employment, 1994

<i>Range of self-employment income (lower limit)</i>	<i>Mean total income</i>	<i>Self-employment income as a percentage of total income</i>	<i>Percentages at each income level who have income from:</i>		
			<i>other earned income</i>	<i>pensions and benefits</i>	<i>investment</i>
£	£				
Negative ¹	15,300	-	69	38	90
0 ¹	5,150	-	2	24	93
1 ¹	10,100	2	56	12	86
500	7,690	9	39	16	87
1,000	6,770	22	35	18	81
2,000	6,350	39	32	10	83
3,000	5,870	59	20	7	81
4,000	6,360	69	19	7	78
5,000	8,000	77	17	7	85
7,500	10,300	84	10	6	85
10,000	13,500	89	8	5	90
15,000	19,400	88	6	7	97
20,000	27,600	87	8	4	97
30,000	42,400	89	13	6	98
50,000	106,700	91	15	4	99
All	15,000	79	18	8	87
Income from each source as percentage of total	100	79	10	3	8

Source: Inland Revenue Statistics, 1994

¹ Boundaries as reported in published tables

Table 5.3 shows the range of sources of income for self-employed people. The table shows that, on average, income from self-employment formed 79 per cent of the total income of self-employed people; income from other earnings was ten per cent; from pensions or benefits three

per cent, and from investments eight per cent. Where self-employed income was less than £3,000, it contributed less than 40 per cent of total income, which suggests that self-employment was often a secondary source of income for people in this range. It was likely to be a supplement to earned income or to a pension, as relatively high proportions (32 per cent or more) in this range had incomes from other earnings, and from pensions (ten per cent or more). When self-employed income was between £3,000 and £4,000, it contributed 59 per cent of total income, and by the time it reached between £5,000 and £7,500 it was 77 per cent of total income, that is, the main source of income.

When self-employed income was in the range £3,000 to £4,000 per year, total income was low - £5,870 per annum - and it was not until income from self-employment reached £20,000 per year, and was 87 per cent of total income, that it approached average earnings from employment. Average income from employed earnings in 1993-94 was £23,432 (from the FES, 1993-94). Table 5.2 (above) shows that 15 per cent of self-employed people had incomes from self-employment at £20,000 or above.

The data suggests that there were three groups of self-employed people:

- One group had lower incomes from self-employment, up to £2-3,000 per annum, where self-employment was likely to be a supplement to a main job in employment or to pensions and benefits.
- A middle group had incomes from self-employment hovering around and above £3,000 per annum (and up to £15,000), where total income was low but mainly obtained from self-employment. In this group, lower proportions of people had income from investments compared with higher earning self-employed people, but lower proportions had income from pensions and benefits compared with lower earning self-employed people. When this group has been sampled for small scale studies (for example Eardley and Corden, 1996a; and Boden and Corden, 1994) the people found here included those in a range of small businesses with low profits, sub-contracted workers, homeworkers, women working part-time, and parents in receipt of in-work benefits.

- The upper group included relatively successful self-employed people, who achieved income from self-employment at a level similar to average earnings levels from employment, and, in some cases, at a much higher level.
- In Table 5.3 above, approximately 22 per cent were in the lower group, the majority of self-employed people fell into the middle category (63 per cent) and 15 per cent were in the upper group.

We do not know whether people whose main income comes from work as an employee, and pay PAYE with Class 1 NICs, are less inclined to recognise their liability to register for Class 2 NICs, or less inclined to pay an additional contribution. This might be tested in further work. The information presented above may be helpful in explaining the numbers and income range of the people who might be affected.

Household income

Although Class 2 NICs are payable on individual earnings, their budgeting strategies may depend on their overall household resources. The budgeting constraints and strategies influencing compliance with Class 2 NICs may depend on household incomes.

The most commonly used and regularly available series on changes in household incomes is FES. In their analyses of the FES, Eardley and Corden (1996b) show that the mean gross weekly household income of households headed by a self-employed person was lower than that of households headed by an employee, in 1980 and 1991, but higher in 1989. Household income of households headed by an employee had grown throughout the period, whereas that for households headed by a self-employed person had fallen between 1989 and 1991. The 1994-95 FES, in the most recently published report (King, 1995), shows that the mean gross household income where the head was self-employed was £513.70 per week which compares with £515.71 where the head was an employee (£408.46 for manual employees and £591.15 where the head was employed in a non-manual occupation). Self-employment includes both manual and non-manual occupations.

For households headed by self-employed persons, earnings from self-employment contributed 66.0 per cent of the household income; earnings from employment 22.3 per cent; investments, 4.1 per cent; annuities and pensions, 2.3 per cent; and social security benefits, 4.4 per cent. In contrast, households headed by an employee obtained less than two per cent of their income from self-employment. Investments and annuities contributed less to the income of employed people than they did to self-employed households. Social security benefits, however, contributed more to the income of households headed by a non-manual employee than they did to incomes of self-employed households. The pattern of sources of income of households with a self-employed head suggests, on the whole, slightly more secure financial circumstances with more income from investments and less reliance on means-tested benefits than employee-headed households.

The FES report (King, 1995) also summarises the importance of self-employed income for different regions, occupations, and over time. The information is presented as the proportion of gross weekly household income contributed by self-employment. Self-employment contributed 9.5 per cent to overall household income in the UK but, regionally, contributed most in the South East (10.4 per cent), Greater London (11.6 per cent), the South West (12.9 per cent), and Northern Ireland (19.1 per cent). It contributed least in Wales, the North West and the East Midlands. The regional variation is due in part to the difference in the numbers of people who are self-employed in each region and in part to the level of self-employed earnings in each region. Secondary analysis of the FES could provide definitive information about the relative levels of earnings from self-employment in different regions and for different occupations.

There has been an increase in the contribution that income from self-employment has made to household income over time. In 1965 it was 7.5 per cent of average weekly gross household income, falling to 5.7 per cent in 1975 and rising to 7.1 per cent in 1985. Since 1990 the contribution from self-employment has not fallen below eight per cent, and rose to 9.5 per cent in 1994-95. This is mainly due to the increase in numbers of self-employed people. Further analysis would be necessary to determine any changes in the level of real earnings from self-employment.

The rise in self-employment throughout the 1980s seems to have led to even greater inequality within the self-employed sector (Jenkins, 1995). Goodman and Webb (1994) show that among

the families in the ten per cent lowest income band (the bottom decile), the proportion of families with self-employed earners has grown steadily, with the sharpest increase taking place since 1980. By 1991, families with self-employed earners made up just over 13 per cent of those with incomes in the lowest ten per cent of the income distribution.

Living standards of self-employed people and households

For tax, insurance and means-tested benefits, income is generally the most easily measured indicator of ability to pay or need for assistance. There is some debate as to whether self-employed income is a good indicator of ability to pay, however, as wealth is not included, and a more general measure of resources might be more appropriate. In the context of means-tested benefits Eardley and Corden (1996a) investigated the living standards of self-employed claimants of Family Credit. This study was a result of a concern in the Department of Social Security that although the incomes of some self-employed people were low enough to claim a means-tested benefit, their living standards might be higher than employees with similar income levels.

For similar reasons we will explore the published information on the living standards of self-employed people, and provide further general background information. This section considers the patterns of expenditure when the head of the household is self-employed, the tenure of such households and other information on the financial circumstances and living standards of the self-employed.

In *Family Spending* King (1995) presents tables of the spending patterns at different levels of gross household income for households headed by a self-employed person. Total expenditure is often used by economists as a proxy measure for permanent income. Permanent income is unaffected by the payment of bonuses, windfall gains and other fluctuations. Total expenditure is also regarded as particularly suitable for estimating the circumstances of the self-employed because of the difficulty in gauging their income at any given time. Average total expenditure (including housing costs) of households headed by a self-employed person in 1994-95 was £401.76 per week compared with average total expenditure of households headed by someone in full-time employment of £370.29 per week. The pattern of expenditure of households with self-employed heads was slightly different from that of households with an employed head. Households with a self-employed head spent a smaller amount on housing per week than

households with an employed head, and less on housing as a proportion of total expenditure. They spent more per week, and more as a proportion of their total expenditure, on food and leisure services.

The proportion of total expenditure spent on necessities is often used as an indicator of low living standards or poverty, and it is interesting to compare this indicator for households headed by a self-employed person and those headed by a full-time employee for households at different levels of income. The levels used for the comparison divide the distribution of household income into five equal bands each containing 20 per cent of the total number of households sampled. This comparison gives an indication of the living standards that self-employment provides when it is likely to be the main household income. Some households headed by a self-employed person may have other members in employment, and vice versa, households with a head in full-time employment may have other members in self-employment. Table 5.4 presents the percentage of total expenditure spent on necessities - housing, fuel, food and clothing - for 20 per cent bands of gross household income.

Table 5.4: Percentage of total expenditure spent on necessities for households headed by a self-employed person and a full-time employee by 20 per cent bands of gross household income, UK, 1994-95

	<i>Head of household is:</i>					
	Self-employed			Full-time employee		
	Gross income less than: (£ per week)	Percentage of total expenditure spent on necessities	Mean total expenditure (£ per week)	Gross income less than: (£ per week)	Percentage of total expenditure spent on necessities	Mean total expenditure (£ per week)
Lowest 20 per cent	224	48	239	316	48	216
Lower 20 per cent	337	44	322	422	47	291
Middle 20 per cent	467	43	390	535	46	351
Higher 20 per cent	673	42	433	702	45	418
Highest 20 per cent		43	625		40	620

Source: Family Expenditure Survey 1994-95 in King (1995)

In the table, the income bands are different for households headed by a self-employed person and an employee. For example the lowest 20 per cent of households headed by a self-employed person have gross household income less than £224 per week, and the lowest 20 per cent of households headed by an employee have incomes less than £316 per week. The income boundary for each band is lower for households with a self-employed head than for those with an employed head. In contrast the mean total expenditure in each band is higher for self-employed households than for those headed by an employee. For example the mean total expenditure of the lowest 20 per cent band of self-employed households is £239 per week compared with £216 per week for a household with an employed head.

The difference between income and expenditure may be a result of the difficulty in measuring self-employed income in surveys - particularly in the FES which reduces information over different time periods to a weekly value (see Eardley and Corden (1996b) for further discussion of the measurement of self-employed income). For the lowest income band, however, the proportion spent on necessities is the same (48 per cent) whether households have a self-employed or an employed head. For all other bands, except the highest, households with an employed head spent a higher proportion on necessities than households headed by a self-employed person. The proportion spent on necessities fell from 48 to 44 per cent between the lowest and next lowest band of households headed by a self-employed person and remained around that level at higher incomes. For households with an employed head, the proportion fell gradually until the highest band where there was a steeper decline.

The difference between income and expenditure of households headed by a self-employed person, is sometimes used to demonstrate the existence of an 'irregular economy'. The argument is that if households spend more than their incomes, they may have hidden resources. This is pursued further in Chapter Seven.

When discussing living standards, it is often useful to have some non-monetary indicators such as tenure of housing, ownership of cars and vans, or ownership of consumer durables. People often find it easier to give information about such items than about income. House ownership is of particular interest for self-employed people because it is sometimes used as collateral in starting a self-employed business. Although information on house ownership is gathered in the FES and

the GHS, it is not presented for the self-employed in the published reports. Some information is available from Curran and Burrows (1989) who use the 1983 and 1984 GHS to show that self-employed men and women (whether or not they have employees) were more likely to be living in owner-occupied accommodation than employees. Among the self-employed, women were more likely to live in owner-occupier households than men: 92.1 per cent (women) compared with 89.3 per cent (men) among those with employees; and 84.8 per cent (women) compared with 75.6 per cent (men) among those without employees. Car ownership was also more likely among the self-employed than among employees - over half of self-employed people had two or more cars in the household, compared with 28 per cent of employees. Fewer self-employed people without employees (40 per cent) lived in households with two or more cars. Information on the ownership of consumer durables among low-income households is available in Eardley and Corden (Table 7.5, p252, 1996a). They argue that care must be taken in interpretation of apparently high living standards in terms of housing, household goods and equipment among self-employed people.

The Contributions Agency has a special interest in ownership of telephones, as a direct dialling system is in use to encourage compliance. No published national data on telephone ownership among self-employed people has been found. The 1994-95 FES shows that 91.1 per cent of households in the United Kingdom had a telephone, but this varied considerably from 69.6 per cent for those with the lowest incomes, to nearly 100 per cent among the better-off (King, 1995). Studies of low-income self-employed families show telephone ownership of 88 per cent (Marsh and McKay, 1993) and 92 per cent (Eardley and Corden, 1996a). However, Boden and Corden (1996), trying to arrange interviews with self-employed fathers who lived apart from their children, found that among 63 men, at least 25 had no telephone at home or were ex-directory. Mobile telephone units were sometimes used by men who needed a telephone at work.

Research on starting self-employment has discussed the financial background required (Keeble *et al.*, 1993). Storey and Strange (1992) found that personal savings were by far the most important source of initial capital, followed by bank overdrafts and loans. House mortgages or loans from relatives and friends were less important. Other studies endorsed this finding (Keeble *et al.*, 1992; Binks and Vale, 1990).

Conclusions

This chapter has pointed to the problems in measuring incomes from self-employment. Nevertheless, the statistical information available is interesting.

There is a wide variability of incomes from self-employment, which is likely to reflect the heterogeneity of self-employed work. Self-employed people are more likely than employees to have very high and very low incomes. Income from self-employment is particularly variable for women. Such variation in income suggests that a variety of approaches may be needed to engage such a diverse population, in terms of Class 2 compliance.

At the level of individual earnings, the mean monthly net labour income of self-employed people in 1991 was greater than that of employees, but this was not the case for women, considered separately. At the level of hourly earnings, in the majority of cases (those without employees) gross hourly earnings of self-employed people in 1992 were lower than those of employees. Further secondary analysis of more recent gross labour income would be useful here.

Those people with earnings from self-employment seemed to fall into three groups: those for whom such earnings are a secondary source of income; those for whom self-employed earnings are the main source, but provide a low wage; and those who are earning similar amounts from self-employment as the average employee. Further research would be needed to investigate whether self-employed people with lower earnings have special problems in paying Class 2 NICs.

In 1995 average gross household income where the head is self-employed was slightly less than that of a household with a head who was an employee. The pattern of sources of household income suggests that households with a self-employed head are, on average, slightly more financially secure than those headed by an employee, in that they are more likely to have income from investments and be owner-occupiers than employees.

Average household expenditures of households with a self-employed head were greater than the expenditures of households with an employed head, although household incomes were lower. Care must be taken with this finding. Some commentators use this finding as evidence of the 'shadow economy' among self-employed people (as discussed in Chapter Seven). Also important,

however, are the reporting and measurement problems in dealing with self-employed income in surveys. Some self-employed people may also be maintaining household expenditures against increasing business debt.

Households in the lowest 20 per cent band of income distribution, whether headed by a self-employed person or an employee, are equally likely to spend on necessities. For higher income households (until the highest income bands) households with a self-employed head are less likely to spend on necessities.

The different kinds of information about financial resources presented in this chapter offer the Contributions Agency three different perspectives. Analysis of individual labour incomes helps to locate self-employed earnings within the general earnings distribution of people with NICs liabilities. Analysis of household incomes shows the overall household resources of households with a self-employed head, which may influence their compliance with NICs liabilities. Analysis of household spending patterns and living standards, in comparison with households headed by an employee, offers further insights into the resources available to self-employed people. There is scope for further research from each of these perspectives, to investigate the links between resources and NICs compliance. The higher standard income data from self-employed people participating in FES and FRS from April 1996 (described on page 76) will offer further opportunities here.

CHAPTER SIX

THE ORGANISATION OF BUSINESS AND PERSONAL FINANCES

This chapter is concerned with the ways in which self-employed people organise and manage their business and personal income. First, we look at the various regulatory regimes to which self-employed people are subject, their obligations to report business income, and their use of help from professional advisors and other bodies. The adequacy and availability of advice and help are strictly 'supply-side-variables', rather than client characteristics, but it seems sensible to include these issues, to set the context for further discussion about compliance. The second section is concerned with the organisation of business and personal income about which there is little direct information available. There is, however, some information about the extent to which self-employed people make private provision for pensions. The third section explores evidence of financial problems, as manifested by financial debt.

Regulation and reporting of income, and help from professional advisors

A number of regulatory regimes require the reporting of income from self-employment. Thus individuals may have to account for themselves at different times, in different ways and under different rules to the Inland Revenue, VAT officials², the Department of Social Security (for contributions, benefits or child support), local authorities (Housing and Council Tax Benefits) or other agencies (legal aid, business start-up schemes). None of these regimes particularly harmonises their demands for information or the computation of income (Boden, 1996).

The Contributions Agency, Inland Revenue and Customs and Excise are currently developing closer working initiatives both to provide information for and seek information from self-employed people. Nevertheless, there is a considerable burden imposed by the state on self-employed people with regard to their obligations to report business income. Further demands are made by financial and commercial organisations, such as banks, building societies, and the pensions and insurance industry. This may be considered in the context of some of the characteristics of self-employed people discussed in earlier chapters. While they form a

² At the time of writing, the current threshold for VAT registration for small businesses was a turnover of £47,000 for the last 12 months.

heterogeneous group, some of the characteristics observed may affect their ability to cope with this range of complexity in the regulation of their financial affairs.

Gravestock (1995) maintains that the growth in self-employment has been accompanied by a relative decline in the use made of professional advisors which may be associated with characteristics of the 'new' self-employed, including subcontracted workers, some homeworkers and those at the margins of the labour market who are seeking alternatives to unemployment (Gravestock, 1995; Bögenhold and Staber, 1991; Hakim, 1988; Meager *et al.*, 1992). The relative informality of much self-employment, the small scale of many ventures and the relatively low use and numbers of formal employees suggests that many people are unlikely to structure their work or 'business environment' in such a way that they have ready and frequent access to expensive technical advice, or to be able to afford such advice. For example, there is evidence that women in some kinds of work, for example childminding or building up what was previously a spare-time activity, may not identify themselves as people running a 'business', with all the obligations that this entails (Boden and Corden, 1994), or consider that they may have a need for professional advice. There have been estimates that only about half of self-employed people employ professional accountants to help them with their accounts and other provision of financial information (*The Accountant*, 1994; Gravestock, 1995). An internal Inland Revenue compliance cost assessment exercise assumes that around 75 per cent of sole proprietors and around 85 per cent of partnerships and partners use an agent/accountant (Inland Revenue, 1994). Their estimates are based on numbers of Schedule D tax assessments, however, and not all self-employed people are assessed for tax.

Limited resources or desire for privacy may mean that self-employed people who do have an accountant only use their services for certain aspects of compliance. Applicants for Family Credit (Boden and Corden, 1994) and customers of the Child Support Agency (Boden and Corden, 1996) preferred to use their accountant only for production of accounts to go to the Inland Revenue. Therefore, among those people who use an accountant, there are likely to be a proportion who confine such use to matters concerning tax dues. Gravestock (1995) reports that the low level of professional accountant involvement leads to the Inland Revenue, in many instances, actually having to do the necessary tax computation on information supplied (something which has been the legal responsibility of the taxpayer for many years). Similarly, Boden and

Corden (1996) found that self-employed people's unfamiliarity with financial information and rules meant that Child Support Agency staff themselves were having to calculate parents' income from raw data supplied.

Nayak and Greenfield, reported in Storey (1994) showed that in businesses with fewer than ten employees, formal monitoring of profits took place in only one-third of businesses, and they were struck by the lack of financial awareness of those operating small firms. They found a significant minority of small businesses which did no adequate formal record-keeping.

Some accountants anticipate that self-employed people may make greater use of professional advisers in the future. For instance, the introduction of self-assessment by the Inland Revenue for all years from 1996/97 is expected to generate extra work for professional tax advisers (*The Accountant*, 1994). Similarly, there is an expectation that assessment of self-employed earnings by the Child Support Agency will induce many people to make use of their accountant in preference to their lawyer in matrimonial matters (*Accountancy Age*, 1994).

The next section looks at what is known about the competence of accountants as professional advisers. This is followed by a section which considers the availability and use of other sources of help and assistance.

Accountants' knowledge about Class 2 NICs

Most professional accountants who work for self-employed people will not be chartered accountants working for the six large accounting partnerships which dominate accounting issues in the UK. Indeed, many accountants may not be chartered accountants at all. Anybody can set themselves up as an accountant in the UK, although only people chartered by approval bodies may certify the accounts of limited companies (Companies Acts 1985 and 1989). The level of fee income available for working with the self-employed will probably be constrained by the low incomes generally available from many businesses. For example, Boden and Corden (1994) found that accountants who did deal with Family Credit applications for clients would often have to write off or defer collection of their fee for this work.

Accountants working for the self-employed will typically be sole practitioners or working in small practices in the 'High Street'. Such practitioners will not necessarily have access to quantities of specialist publications or training support. At the level of the accounting institutions³ there is some interest in self-employed matters. But the institutions tend to be dominated by the large players and their journals reflect their interests for the most part, and not those of very small practitioners. One important regional difference may be in Scotland. The Institute of Chartered Accountants in Scotland has a greater proportion of small practitioners, and there is an example of a group of accountants in a remote rural area effectively lobbying for change in the interests of low-income self-employed clients (Boden and Corden, 1994).

The Institutes do provide some information on self-employed matters through journals such as *Accountancy* and *Accountancy Age*. In addition, there are training/briefing materials made available through various private ventures (see, for example, *Accountants Digest*, 1994). Publishing houses provide comprehensive guides to the income tax and VAT systems, but similar information is less available for matters such as social security and National Insurance. There may be two reasons for this, which are not mutually exclusive. One may be that, to a professional adviser, the level of knowledge required for such matters is limited and straightforward. Secondly, there may be a low level of demand for publications in such areas because it is a low value area of work. For instance, National Insurance rarely features in any professional publications unless large amounts of money are at stake: when schemes to avoid employers' contributions by paying employees in kind were becoming popular, there was a plethora of articles on 'how to do it' (see, for example, *Accountancy*, 1993; *Accountancy*, 1994). If the amount of money collected through National Insurance Contributions continues to rival that from income tax (Dilnot and Webb, 1988) there may be greater incentives for professionals to get involved and interested in National Insurance. However, such interest might well be concentrated at the upper end of the value scale (and therefore almost undoubtedly concerned with Class 1 contributions).

The other major source of information and explanation for professional advisers, apart from their own profession and its publications and services, comes from government agencies and

³ The main professional accounting institutions are ICAEW (Institute of Chartered Accountants in England and Wales); ICAS (Institute of Chartered Accountants in Scotland); and ACCA (The Chartered Association of Certified Accountants).

departments. The Inland Revenue has a long tradition of providing guidance notes to accounting professionals, and of recognising their work, other agencies less so (Boden and Corden, 1994). Thus, accountants and tax advisers are assumed to be proficient in the areas of taxation (Gravestock, 1995), but such assumptions cannot necessarily be made in other areas where professional involvement and engagement is at a lower level, affording accountants little opportunity to learn by experience.

Areas of professional interest can be signified by occurrence of conflict and dispute (although, of course, the absence of disagreement does not necessarily signify professional disinterest). Professional advisers have many, and often public, conflicts with the Inland Revenue and Customs and Excise (see, for example, *Accountancy*, 1994b). There is little evidence of similar dispute in the area of National Insurance (but some: see *Accountancy*, 1993). Accounts in professional journals of disputes between advisers and the Benefits Agency or the Child Support Agency are almost non-existent.

All of this suggests a low level of professional advice available about National Insurance matters, even to those self-employed people who use accountancy services. Further research on the level of information and advice about National Insurance given by professional accountants would be helpful here.

Other sources of advice

It is clear that many self-employed people must rely on other sources of information and advice about the systems and rules to which they are subject. Assistance in getting things right is likely to come largely from the state authorities themselves. This has been recognised by the Inland Revenue in its moves towards self-assessment and the current year basis of assessment for the self-employed. Advance advertising has been extensive, and the Inland Revenue has retained an option whereby, in return for early submission of information, it will calculate a taxpayer's liability (MacDonald and Whitehouse, 1993; Gravestock, 1995). Similarly, the Contributions, Benefits and Child Support Agencies have all invested significant effort in information dissemination to the self-employed. The Inland Revenue and the Contributions Agency have also worked together to provide more harmonised and integrated advice and guidance (for example, Leaflet 1R56/N139, 'Employed or self-employed?' and, with Customs and Excise, leaflet CW1, 'Starting your own

business?'). It may be that this information should be more directly targeted: for example at subcontractors, or at women on low incomes, who form increasing numbers of the self-employed.

If the state authorities are to assume a responsibility towards the self-employed in terms of special advice and assistance in 'getting it right', then the staff who deal with self-employed people must be trained in the relevant areas, and may need familiarity with the way in which small businesses and other forms of self-employed work, as well as basic accounting techniques. The Inland Revenue has a long tradition in training in accountancy matters for its staff, but there are known to be problems here for both the Benefits Agency (Boden and Corden, 1994) and the Child Support Agency (Boden and Corden, 1996). Evidence about training and expertise about self-employment in the Contributions Agency is not widely available, but some reported incidents suggest there may be problems here (*Accountancy*, 1993).

The main associations for organised representation of self-employed people, as a body, are the National Federation of the Self-Employed and the Forum for Private Business. Interestingly, the National Federation of the Self-Employed arose as a consequence of concern among self-employed people about the National Insurance scheme (the introduction of Class 4 graduated contributions). However, such organisations do not attract large memberships; the heterogeneous nature of self-employment tends to limit opportunities for development of solidarity on the sole basis of employment status (McHugh, 1979). These organisations do provide a useful source of help and advice for members, but their focus of interest and activity tends to reflect the interests of the small business sector, from which most of their members are drawn. The associations' concerns and activities about National Insurance centres mainly around employers' responsibilities for employees in this respect, and the burden of these responsibilities (private communication with authors).

It appears that an important source of information and advice about management of financial regulation for self-employed people may be the numerous trade journals, newsletters and guides from trade and professional associations. A consultation with 50 owners of small businesses in manufacturing, services and retail trades (Macmillan *et al.*, 1989) revealed that the majority did not belong to a small business association, but their most common affiliation was with trade associations and the Chamber of Commerce. Their most commonly cited sources of information

and advice about regulatory matters were accountants, banks and solicitors. However, two-thirds of the sample belonged to a trade association, nearly all of whom reported reading their trade journals and newsletters. There was a general irritation by and disregard for unsolicited mail, including government material.

There are a number of books and guides to entry and management of self-employment. The British Lending Library lists nearly 40 titles published since 1980, and most include at least some reference to National Insurance arrangements. There is no information about the extent to which such books are read.

In summary, this section has explained that not all, and possibly only about half of all self-employed people employ accountants to help them with financial matters. Much of the recent growth in self-employment has been in areas of low-income self-employment where resources to pay fees for accountancy services are likely to be limited. Where the self-employed do use accountants these are often small practitioners who have little or no institutional involvement or membership, and their levels of expertise or interest in Class 2 NICs are unlikely to be high. Some self-employed people may draw on small business associations, or acquire information from reading their trade journals, but for many, the main or only formal source of information about National Insurance is likely to be the Contributions Agency itself. We might expect that there will not be high levels of knowledge and understanding of the various regulatory systems among the self-employed, as a whole.

Managing business and personal income

Most employees have little direct responsibility for paying Class 1 contributions. Self-employed people, however, have to fit payments of Class 2 NICs into their normal management of business and personal income. Knowing more about such patterns of management might throw light on circumstances and situations which either encourage Class 2 compliance, or make non-payment more likely. There appears to be little direct evidence of the day-to-day management of the business and personal income of self-employed people, and personal budgeting strategies. The well-known study of money and marriage conducted by Pahl (1989) did include some self-employed earners, but these were not separated out in her analysis.

Earnings generated by self-employed work come in a variety of ways. We might expect those people who are 'paid' on a weekly or fortnightly basis, such as many homeworkers (Felstead and Jewson, 1996) and subcontracted workers, to conceptualise their earnings and draw on their resources in rather similar ways to people working as employees. For many kinds of self-employment, however, monies come in as fees, or payments, from which expenses must be deducted to construe profits, and decisions must be made as to how much can be taken from the business income as 'drawings'. There may be tensions between maintaining cash flow for the business, meeting regulatory demands for tax, National Insurance and VAT, and maintaining household living standards.

A further complexity is the fluctuation in income which is common in some kinds of self-employment (Brown, 1992; Rubery *et al.*, 1993). There are well-known cyclical patterns of work and trade, such as the seasonal income flow among farmers, hoteliers, and outdoor construction workers, and the retail sales cycles. Eardley and Corden (1996a) describe swings in income in other kinds of low-income self-employment. Taxi drivers, childminders, and book-keepers, for example, depended upon a fluctuating demand for services associated with university terms, school holidays and accounting periods among small businesses, respectively. In the Social Change and Economic Life Study, which surveyed households in six selected labour markets (Rubery *et al.*, 1993) self-employed people were asked how their pay was determined. The most frequently reported way was according to goods or services sold, especially for men (57.8 per cent). Income variation was very common, reported by one-third of self-employed women, and 37 per cent of men. Fluctuating incomes mean that it can be hard for some people to know exactly what their level of earnings is, and how resources may, and should most sensibly be apportioned (Eardley and Corden, 1996a).

A stream of work on low-income families with self-employed earnings provides some information about the way that income is generated and managed in such families, and how earnings are allocated and transferred for personal expenditure (Boden and Corden, 1994; Eardley and Corden, 1996a). In the smaller enterprises, the distinction between business and household finances was often not made. Only just over half of the group studied in detail by Eardley and Corden (1996a) kept bank or building society accounts for their work that were clearly separated from household or personal accounts. These tended to be people with genuine trading or service

businesses. Earnings from subcontracted or quasi-self-employed work were more likely to pass through the same bank accounts, either individual or joint, as household expenditure. In two-parent families, it was usually the view of both partners that financial decision making was a joint process, while women tended to deal with most of the household budgeting and expenditure. Men sometimes took responsibility for handling larger domestic bills, like mortgage payments. There was great variation among the families in the types of systems of control over financial resources, and patterns of managing and budgeting. In some of the more established businesses, however, it was the woman in the couple who did most of the book-keeping and had considerable responsibility for financial aspects of the business.

It was not clear from this work whether National Insurance contributions were associated more with business finance or household expenditures, nor how they were budgeted for and paid. Those few families who had any personal savings sometimes explained that these represented monies put away against future tax demands. Commitment to paying Class 2 NICs was variable. Some people appeared not to be paying contributions when they should have been, and there were examples of people in substantial arrears, a matter that was not pursued further in this study.

There is some evidence from the literature on debt that quarterly bills are hard for people living on low weekly incomes (Rowlingson and Kempson, 1993, and see later section). Some kinds of self-employment are arranged to deliver weekly income, for example some homeworking, child-minding, taxi-driving. This suggests that quarterly bills from the Contributions Agency may not encourage compliance among some self-employed customers, and this might be investigated further.

Little other literature has been found about the organisation of earnings from self-employment, although it is clear from research on people who get into debt, reviewed later in this chapter, that problems in managing fluctuating incomes from self-employment can lead some people into financial distress. One issue that would be useful to pursue is whether Class 2 NICs are conceptualised as business or personal expenditure, and, in couples, which domestic partner takes responsibility for dealing with them.

Savings and investment

One way in which people organise their personal expenditure is to make savings and investments, and one of the reasons for saving is to insure against future insecurity. Indeed, private saving and investment might seem, to some self-employed people, an alternative option to participation in the National Insurance scheme, rather than an additional option. Detailed information about types and levels of savings is collected in the major household surveys (FES, GHS and FRS). However, disaggregated data for self-employed people are not available in published tables.

Personal pensions and insurance

A further aspect of organisation of personal resources is investment in private pensions and insurance. We might expect some self-employed people to have a special interest in personal pension provision, since they can only have access to occupational pensions or SERPS if they have acquired entitlement through earlier periods of employment. Nor do they have the same access to industrial injuries benefits as employees. The exclusion of self-employed people from such benefits has attracted considerable criticism (Brown, 1990; 1992).

Pensions are problematic for self-employed people for a number of reasons. First, the relatively low earnings of a substantial proportion of the self-employed mean that many may simply be unable to afford to pay towards a pension. Tax relief is available on such contributions, starting at 17 per cent of income and rising with age to 20 per cent. The low incomes of some self-employed people means that they are unable to make adequate payments into such schemes to secure a good income in retirement (Eardley and Corden, 1996a). Fluctuating incomes also make it hard for some people to maintain payments (Brown, 1994).

A further problem identified by some observers is that personal pension schemes often provide low returns for investment, while being expensive to administer, and as contribution-defined schemes are less predictable than benefit-defined schemes (Brown, 1990, 1994; Townsend and Walker, 1995; Nesbitt, 1995). Most personal pension schemes are 'money purchase' schemes, dependent on fluctuating investment markets, and often not inflation-proofed, and there has been little recent change in pension products available to the self-employed (*Accountancy*, 1994a). Nevertheless, there were major marketing initiatives to sell personal pension schemes in the late

1980s, especially to employees (Nesbitt, 1995). There are now something like five million people altogether (employees and self-employed) in the UK with personal pension plans (Townsend and Walker, 1995).

There is some evidence that the number of self-employed people with personal pension provision has been low (see Eardley and Corden, 1996a) and is only gradually increasing. Analyses by Brown (1992) based on special tabulations provided by the Inland Revenue were updated by Eardley and Corden (1996a). These suggested that the proportion of self-employed people who were allowed retirement annuity tax relief or claimed tax relief for gross contributions to a personal pension, had grown from around 36 per cent of all self-employed people in 1987-88 to 38.5 per cent in 1989-90.

Data from the 1994 General Household Survey (Bennett *et al.*, 1996, Table 8.12) show 56 per cent of self-employed men currently belonged to a personal pension scheme, and 34 per cent of women. Some people reported having previously had a personal pension scheme, but no longer belonging, but one-third of men and nearly two-thirds of women reported never having had a personal pension scheme. (Data from the Inland Revenue tabulations, and the General Household Survey are not exactly comparable). Brown (1994) points out that movement in and out of pension schemes can be expected among self-employed people whose incomes fluctuate. The Inland Revenue Survey of Personal Incomes shows that in 1994/95 there were 1.0 million self-employed holders of personal pensions, and 0.9 million holders of self-employed Retirement Annuity contracts (unpublished analyses of Inland Revenue Survey of Personal Incomes).

There is less likelihood of contributing to a personal pension among self-employed people at lower earnings levels. Analysis of the Family Credit administrative statistics showed that it was unusual for low-income families with children to be making contributions - in 1991 only 17 per cent of self-employed Family Credit recipients were making payments towards personal pensions (Eardley and Corden, 1996a). The 1994 General Household Survey also shows that the likelihood of belonging to a personal pension scheme increases with length of time in self-employment - among men who had been self-employed for five years or more, two-thirds were members of a private scheme. Analysis of the 1991 General Household Survey showed that

smaller proportions of self-employed people from minority ethnic groups were paying into a personal pension scheme compared with white self-employed people (Hancock *et al.*, 1995, p48).

A batch of questions added to the February 1995 Omnibus survey, conducted by the Office of Population Censuses and Surveys (OPCS) sought public perceptions of non-state pensions (Hawkes and Garman, 1995). Among those interviewed who said they were self-employed, 56 per cent reported having a personal pension. In general, among both men and women, the proportion who had given any thought to retirement income arrangements increased with age, peaking in the 35-44 age group, and then declining. Not surprisingly, self-employed people with non-state provision were more likely to have given this some thought than those without. Forty-seven per cent of the self-employed said they were very or fairly confident that they would get a state pension. There was considerable lack of knowledge among all participants in the survey, including those who were retired, about how state pensions are funded, and associated with this, much confusion among those who thought they understood.

In this study, people were asked where they would invest extra money for retirement. Among the self-employed, not surprisingly, the most frequent choice for those with a personal pension was that form of investment. Among those without a personal pension, 46 per cent would look first to other types of savings investment, such as an endowment policy or TESSA, and less than a third to a personal pension scheme. Only three per cent of those without a non-state pension mentioned voluntary NICs in this respect, and none of those with a personal pension. Interestingly, the self-employed were one of the groups more likely to be aware of proposed changes in government pensions policy, including those relating to occupational pensions, to which they currently did not have access.

Turning to private insurance policies for illness and accident protection schemes, there is rather little information available. Various forms of policies for accident and sickness insurance have been developed, but these can be expensive, and vulnerable to fluctuations in net income (Gaselee, 1983). Brown (1992) pointed out that some schemes identify high risk occupation groups among self-employed people, who are then charged premiums or excluded altogether. Luckhaus and Dickens (1991) concluded that none of the available insurance provisions for self-employed people in the UK in 1991 would provide reasonably priced cover for short-term sickness. Private

health insurance (PHI) for long-term incapacity is, again, risk-related and expensive, and appears to be little used by self-employed people (Brown, 1994). The Office of Fair Trading (1996) explains some of the problems of PHI for self-employed people, including uncertainties about future income, and the phenomenon of 'over-insuring' which is a common feature of PHI schemes. Among those self-employed people who did make claims in PHI, most claims due to disability were associated with musculo-skeletal problems (39 per cent) and mental illness (19 per cent) (Office of Fair Trading, 1996, p55). Case studies of 28 self-employed people who ran businesses with fewer than five employees (Rainbird, 1991) showed that only one-quarter had any form of sickness insurance.

Brown (1994) suggests that it is hard to find any kind of private insurance for income loss due to unemployment or maternity absence. Also, business insurance such as public liability and fire insurance may take priority among some self-employed people.

The general conclusion seems to be that although the proportion of self-employed people belonging to personal pension schemes is gradually increasing, large numbers are currently making no private arrangements. Among those who are, a proportion are unlikely to get good returns for their investment. In general, the self-employed population is not well covered for financial security in retirement through private schemes, which might seem to offer valuable 'alternatives' in comparison with the state pension scheme, and a reason for non-compliance with Class 2 NICs. They do think about planning financial security in retirement and it seems to be those in younger age groups, under 45 years, who give this most thought.

Incidence and level of debt

Another way of organising personal financial matters is to use credit. The terms credit and debt are relative, of course, and the point at which use of credit turns into problem debt varies according to the creditors and debtors concerned. It is worth remembering that current payment methods for Class 2 NICs in effect allow some access to credit, before turning into 'debt'. The Contributions Agency will be interested in all forms of problem debt, not arrears of contributions only, because any kind of financial pressure is likely to affect budgeting practices and prioritising of resources.

Mortgage lending and consumer credit both doubled between 1980 and 1987 (Berthoud, 1989). The first systematic study of credit use by private households was conducted by the Policy Studies Institute (PSI) in 1989 (Berthoud and Kempson, 1992). (Some earlier surveys of public attitudes to consumer credit which contained some information about borrowing, are cited by Berthoud and Kempson.)

Most credit transactions do not fall into arrears, but debt is a widespread problem. A number of studies have looked at various aspects of debt, most of which have been concerned with arrears to a particular creditor: rent arrears (Duncan and Kirby, 1983); fuel debts (Berthoud, 1981; Rowlingson and Kempson, 1993); mortgage arrears (Doling, Ford and Stafford, 1988; Ford, 1988; Ford *et al.*, 1995); and water rate arrears (Herbert and Kempson, 1995). There have also been studies of the experience of debtors, based on research conducted with specialist money advice services (Parker, 1990; Mannion, 1992). The 1989 PSI study (Berthoud and Kempson, 1992) remains the only national representative study of the pattern of credit use, and the nature and extent of indebtedness set alongside the context of budgeting at different levels of income.

The literature cited above has been interrogated to find pointers which may be useful in the National Insurance payment context. In fact, there is very little direct mention of non-payment of NICs or, indeed, income tax arrears. It is not clear whether those designing the research decided to omit such topics, or whether respondents do not report problems with tax and insurance. However, there is some information about self-employed people's use of credit, and their problems with other kinds of debt.

In the general population, use of credit in 1989 was highest in the age group 30-39 years, and declined steadily with age (Berthoud and Kempson, 1992). This pattern had not changed for two decades, although all age groups had increased their number of sources of credit. In 1989, 83 per cent of people in their thirties used, on average, three different sources of credit. In every age group, couples used more credit than single people, in terms of both any active use and number of sources, and couples with children used more credit than those without. Use of credit, overall, was highest among families with children, and increased with the number of children.

Use of credit varied little between households at different levels of income, but it fulfilled different roles. Put simply, higher income people used credit for buying extra goods or services, lower income people to help manage budgeting problems. Berthoud and Kempson found that self-employed people used substantially more credit than employees. They noted that it was not those with their own businesses who were most active, but those working for larger organisations, [author: these would probably include, for example, subcontractors]. This finding, put together with the general characteristics of those people who use most credit, tends to suggest that among the population with Class 2 liabilities, a substantial proportion will generally make routine use of credit facilities.

Some people within the general population deliberately choose not to pay bills until the last moment, for example waiting for the 'red bill' from the utility companies (Rowlingson and Kempson, 1993). However, taking an overall perspective, only a small proportion of credit arrangements turn into problem debts. There are no official statistics which cover all types of debts, however. Berthoud and Kempson (1992) suggest that in 1989 some 2.8 million households were in arrears of some kind. The risk of problem debt concentrated among:

- younger people
- those with children
- those with lower incomes
- those who used several sources of credit, and
- those who gave least priority to keeping up with payments.

Self-employment, by itself, did not increase the risk of problem debt. Against this overall picture of the general use of credit, and risk of problem debt, other studies offer additional perspectives.

Detailed discussions with members of households experiencing problem debt have identified instability of income as one predisposing factor. For self-employed people, fluctuating incomes may be a regular feature affecting personal budgeting, as described previously. Some self-employed people routinely face large swings in cash flow through their business. Inevitably, some are less experienced or successful than others in balancing their income against commitments. In addition, the practice of diversion of domestic expenditure to solve temporary business cash flow problems leads some into long-term financial difficulty (Ford, 1988). Herbert and Kempson

(1995) described how swings in earnings from subcontracted work led to budgeting problems and failure to pay water bills, and evidence is emerging that some self-employed people may be particularly vulnerable to mortgage default. A NACAB (1993) study of mortgage arrears and repossessions showed that some self-employed people with erratic business income found it hard to make regular mortgage payments, and could face additional problems. Some could discover, too late, that their mortgage protection policy did not cover self-employment, or insisted on business liquidation before paying out. There is little official information about secured loans, but the NACAB study pointed out that taking out a secured loan (a second mortgage, secured on the home) was one way in which self-employed people sometimes raised business finance, and secured lenders could be less inclined to renegotiate terms when borrowers got into difficulty.

Ford (1989) argues that certain kinds of employment which seem to be increasing, including casual and contract arrangements, may actually enhance the risk of mortgage arrears. Owner-occupation with a mortgage is a form of tenure based on an adequate, stable and secure income, but self-employed subcontracting often meets none of these criteria. A recent study of mortgage borrowers in arrears and households who have experienced repossession (Ford *et al.*, 1995) suggests that business failure is an increasing trigger for mortgage arrears, indeed, the third most important trigger. Self-employed borrowers were not more likely to be among those in arrears but among the self-employed who were in arrears, 12 per cent said that business failure was the main reason for their arrears. As found in previous studies, the majority of all those in arrears who had earnings were in some kind of manual work. Self-employed borrowers in arrears were more likely to be drawn from among those in forms of quasi-self-employment, for example subcontracted workers in the building industry. Only half were running businesses of their own. Business failure is, however, one of the causes of loss of income leading to problem debt. Some studies also show that when a business is collapsing, the dividing line between loss of earnings and unemployment is not a clear one; and for some people, disappointment and reluctance to admit defeat delay their registration as unemployed, exacerbating their financial problems (Rowlingson and Kempson, 1993; Ford, 1995).

Strategies for managing problem debt include curtailing expenditure and activating resources. There is some evidence that social protection is an area in which cuts in expenditure are made. Mortgage defaulters described cutting payments on life and property insurance (Ford, 1988).

Although Class 2 NICs were not specifically mentioned, we might expect that some people would consider these when looking for possible cut-backs, although, of course this would increase overall indebtedness. In the same study, some mortgage defaulters tried to increase their income by taking second jobs. The kinds of work described included ways of working that might count as self-employment, in a social security context, for example 'a Monday market stall' and 'evening work as a canvasser'.

In summary, research and literature on personal indebtedness includes almost no direct information about tax or National Insurance arrears. Those people in the general population who do get into financial trouble are more likely to be younger, to be families with children, to be on lower incomes, to use several sources of credit and to give least priority to keeping up payments. The evidence suggests that self-employed people, on the whole, are not a group at special risk of problem debt. However, managing fluctuating incomes and collapse of business are features associated with problem debt among self-employed people, and some self-employed people may be particularly vulnerable to mortgage arrears. Most people experiencing problem debts look for ways of cancelling or postponing some expenditure in attempts to regain control. We might expect NICs to be considered when looking for possible cut-backs and further research is needed here. Other strategies for managing problem debt include looking for extra work, and the jobs that people find may be in the marginal sectors, including self-employed work.

Conclusions

Self-employed people have obligations to report income under a number of regulatory regimes. Not all self-employed people use an accountant to help them organise their financial affairs. There is probably a rather low level of professional advice available about National Insurance matters from accountants, anyway. Membership of associations for self-employed business people is low, as is union membership, as we saw in Chapter Three. Trade associations, and their individual trade journals and newsletters do provide a source of advice and information about regulatory matters. For many self-employed people, however, the main or only source of information about National Insurance is likely to be the Contributions Agency itself.

We know little about the organisation of earnings from self-employment within personal budgeting strategies but it is clear that in some forms of self-employment fluctuations in income

complicate the management of personal resources. Little is known about whether Class 2 NICs are conceptualised as business or personal expenditure. The distinction between business and household finances is not always made, however. It would be useful to conduct further research on the conceptualisation of NICs within financial planning and expenditure among self-employed people.

Although the proportion of self-employed people belonging to personal pension schemes is increasing gradually, large numbers are currently making no private arrangements. Again, further research would be useful to investigate private provision for financial security among self-employed people.

Self-employment, by itself, does not increase the risk of problem debt. However, instability or fluctuation in income is a predisposing factor, and business failure seems to be an increasing trigger for mortgage arrears. Strategies for managing problem debt may, for some people, involve cutting back expenditure on social protection, or seeking additional earnings in forms of work that may count as self-employment.

CHAPTER SEVEN

UNDERSTANDING OF AND ATTITUDES TO PERSONAL FINANCIAL RESPONSIBILITIES

As in all aspects of compliance with the law, and participation in democratic society, people act according to their own knowledge and understanding of their position, and according to individual attitudes and preferences. We can expect to find links between these different kinds of influence. Previous research on take-up of benefits has shown how attitudes and feelings may affect levels of understanding about social security (Craig, 1991). In a similar way, we might expect that people who feel disinclined to pass over part of their earnings to a government agency may not try hard to discover whether they should be doing so or how the contribution system works. There are likely to be a number of interacting factors at the client level which lead to compliance or non-compliance. For the purposes of the review, this chapter reflects the main lines of the literature available on understanding of and attitudes to financial responsibilities, in which there appear to be three key areas:

- *Comprehension and understanding*
Without comprehension and understanding of obligations, systems and entitlements the chances of successful compliance by individuals are likely to be reduced, as will be the efficiency and effectiveness of the authority attempting to gain that co-operation.
- *The 'irregular economy'; evasion and fraud*
Whatever the level of understanding there are likely to be some people who evade their obligations. Sanctions or punishments may act as deterrents.
- *Rewards for compliance*
In some regulatory schemes, including National Insurance, compliance may confer reward, and there is then some incentive in participation.

The following sections look at each area in turn. There is very little direct evidence about these issues in the specific context of NICs and the chapter draws mostly on literature about taxation, social security benefits and 'the irregular economy'.

Comprehension and understanding

The previous chapter suggested that levels of understanding of the various regulatory systems to which they are subject are unlikely to be high among self-employed people. This is the assumption of the Inland Revenue - one of the primary motivations for the simplification of self-employed taxation through the introduction of a current year basis of assessment along with self-assessment has been a belief that the self-employed of the 1990s are, generally speaking, not best able to cope with the complexities of the traditional system (Shipwright, 1992; MacDonald and Whitehouse, 1993; Gravestock, 1995).

In the field of social security, work on Family Credit (Boden and Corden, 1994) suggested that most self-employed applicants did not have a good understanding of the rules by which their nominal weekly income was calculated. People usually either accepted what the Benefits Agency told them or, in some cases, referred the matter to their accountant. Similarly, in dealings with the Child Support Agency, few parents studied had any real understanding of either the administrative procedures or the technical rules for calculation of income (Boden and Corden, 1996). Those who had dealt with the Child Support Agency seemed more likely to have an accountant, and to involve them in the process. This may be because not all the parents assessed by the Child Support Agency were at the low income levels of the Family Credit claimants.

Information on levels of understanding about contributions, and National Insurance in general, among self-employed people, and areas which pose special problems for them, is less easy to access. In the accountancy literature there are some short pieces which indicate that there are areas of complexity where individuals have trouble with comprehension (for example, the situation of married women with reduced rate elections, discussed in *Accountancy*, 1993) but these are few and far between. There is little in the available literature on VAT about people's knowledge and understanding.

Turning to the social policy literature, there is some relevant information. First, there is some qualitative evidence that low-income people may not recognise themselves as formally self-employed for purposes of social security. Interviews with self-employed parents entitled to income-related benefits (Boden and Corden, 1994; Eardley and Corden, 1996a) showed that some people did not identify themselves as 'workers', while others did not cast themselves on the correct

side of the employee/self-employed divide. Those who did not realise that they were technically 'working' were usually in transitional situations, for example people who had built up a small-scale activity while claiming out-of-work benefits, and did not realise that as their business grew, they had passed the 16-hour administrative bench-mark which distinguishes those 'in' and 'out' of work. Most such people had very low earnings at this stage, and were unlikely to be accruing debt to the Contributions Agency. Nevertheless, they had not applied for a Certificate of Exception on the grounds of low earnings, and would have been among those missing from the Register. Financial problems could arise for such people if they had not claimed in-work benefits, and had received over-payments of out-of-work benefits.

Another situation met among the self-employed Family Credit population (Eardley and Corden, 1996a) was that in which people had technically started work but not yet made any money. The first months of setting up a new business may involve heavy expenses, but no receipts, and when most, or indeed all income still came from benefits and/or Business Start-up allowance, it was sometimes hard for people to realise that their formal situation had changed. Similar confusions were found at the other end of a period of self-employment. When a business was running down and there had been no business receipts for some time, people sometimes thought of themselves as 'having no work' or 'doing nothing' before the date at which they were formally recognised as entitled to out-of-work benefits.

As well as problems in self-identification as a person doing 'work', the same studies on Family Credit showed problems of self-identification as 'self-employed'. There were confusions in both directions - company directors continued to think of themselves as self-employed, after incorporating their company, while some subcontractors talked about their 'employer'. It is those who failed to think of themselves as self-employed and wrongly cast themselves as employees that are of interest here. Such people tended to be people working in relative isolation, sometimes at home. Their idea of self-employment was of 'being in business' and this did not fit their experience of having 'an employer' and receiving regular 'wages'.

This finding has been confirmed by recent research with homeworkers (Felstead and Jewson, 1996). In-depth interviews with 338 people working at home in manufacturing or lower level service jobs pursued issues of employment status and liability for tax and National Insurance.

Fifteen per cent were unable to say whether they were self-employed or employees, and 20 per cent did not know how their work supplier regarded them. There were regional patterns in levels of certainty about employment status, with uncertainty particularly pronounced in the London borough sampled, and among minority ethnic groups, including Bangladeshi respondents, Pakistani and Chinese.

It seems likely that confusion, misunderstanding, or lack of interest in employment status will be contributing to non-compliance with regulatory schemes. In the National Insurance context there may be delays in registering or failure to maintain payments. Those people who are in such situations may well be earning so little that they would not be liable to make payments. Some of those studied in previous work on Family Credit (Eardley and Corden, 1996a) had not registered as self-employed with the Contributions Agency, but if they had, they would have been granted a Certificate of Exception. On the other hand, some had increased their earnings to the point at which they were liable but did not realise their position had changed and they should have been paying. There was also some evidence from this research that if people did eventually realise that they might be liable for Class 2 NICs, anxiety about possible arrears and uncertainties about what might happen if they did then contact the Agency, put them off doing anything about it even longer. It is important that patterns of non-registration do not turn into patterns of non-payment.

It might be useful to think of ways of 'targeting' people in transitional situations at the beginning and ends of periods of formal self-employment, and people in 'grey areas' of employment status. Hakim (1987) concluded, from a national survey of homeworkers using the 1981 spring Labour Force Survey as a sampling frame, that ambiguities and uncertainties about employment status are concentrated among homeworkers, among labour-only subcontractors working for a single employer, among women and among the lowest paid. One-third of the homeworkers studied, (and the home-based workers in general) were confused or uncertain about their employment status. Such uncertainties were often associated with the fact that earnings were so low that there had never been any practical need to address or ascertain employment status. In earlier developmental work with 50 homeworkers Cragg and Dawson (1981) found widespread uncertainty about National Insurance requirements. Most of these respondents had very low earnings. Only about six people reported any involvement with National Insurance, either by paying their own contributions, obtaining a Certificate of Exception or through employers'

deductions from pay. The topic was 'often lumped together with tax but gained very little prominence' (p31).

Self-identification of employment status is not the only source of misunderstanding and difficulty. There is evidence that some people who correctly identify themselves as self-employed experience problems in understanding their position regarding National Insurance and what is expected. In a national omnibus survey, questions were asked of recent, lapsed and potential self-employed people, to explore some of the possible barriers to business start-up (Bevan *et al.*, 1989). Approximately one-tenth of each of the three groups would have liked more help with matters concerning tax/VAT/ National Insurance when they were setting up their business. Eight per cent of the lapsed self-employed, and four per cent of the recent self-employed had encountered problems with National Insurance. Even higher proportions of both groups had envisaged such problems. Problems that were encountered included practical difficulties, such as the time and work involved, as well as the financial problems associated with finding the money to pay the contributions, but people also reported that their difficulties had included 'not knowing how much is needed'. In a further report based on this research, which included 33 depth interviews, Hakim (1989a) suggests that the problem of dealing with government regulation and paperwork (tax, VAT and National Insurance) for all small businesses should not be under-estimated. Coping with the basic paperwork and book-keeping was found onerous, and resented, even when known to be essential. This may help to explain why some people experience delays in registering appropriately with the Agency, and initiating payments, and why some slip into arrears.

There are a number of studies which provide evidence that people find problems in handling Class 2 liabilities, but the way in which research questions were asked and data presented means that it is hard to separate problems in understanding from other experiences of difficulty, such as practical negotiations with the Agency, or budgeting and financial problems which affect payment records. For example, the Agency's own Customer Satisfaction Surveys asked those self-employed customers who said they found it difficult to set up arrangements for their contributions what could have made the process easier. A wide variety of suggestions were made, some of these pointing to problems in understanding, but not to specific areas of misunderstanding. In the 1994 customer survey 15 per cent of all currently self-employed customers included said that they had found it difficult to set up arrangements to pay, and among these the most frequent suggestion

for improvement was for more easily available information (Craig, 1995, Table 5g) but we do not know what kind of information people wanted.

Surveys of small firms and private businesses that are available demonstrate that dealing with administrative requirements and 'red tape' is a priority concern affecting businesses. This concern is likely to encompass problems with administration, such as the amount of work required, as well as problems of understanding, and it is not possible to separate these, from the data available. Administrative paperwork and financial returns may well take longer if people have incomplete understanding of requirements. Requests for further information may be necessary as a result of initial misunderstandings, lengthening the administrative process. We might expect that some of the concern reported by small businesses would include dealing with Class 2 NICs. However, when respondents include self-employed people who are employers, overall responses cover concerns about responsibilities for their employer contributions, as well as their own liabilities, and published data do not allow disaggregation. For example, the quarterly surveys of small firms conducted by the Forum of Private Business consistently show concern about 'red tape' as one of the most important problems for businesses. Seventy per cent of respondents to the first quarterly survey of 1996 (FPB, 1996) had five or more employees, however. Similarly, administration of PAYE and NICs was ranked as the second most important administrative burden on business in a survey of 800 proprietors and company directors organised in 1995/96 by the Institute of Directors (Institute of Directors, 1996). Only five per cent of respondents had no employees, however, and we do not know whether any of the concerns expressed were attached to the employers' own contributions.

In summary, there is clear evidence of lack of understanding, confusion and uncertainties about National Insurance liabilities among people in 'grey areas' of employment, or in transitional situations. There is also evidence that dealing with National Insurance can be problematic both for people established in self-employment and for those setting up new businesses and some of the problems arise from lack of knowledge and misunderstanding. For those self-employed people who are also employers, their liabilities for employer contributions add a further dimension to the problems they encounter, and it is hard to separate their experiences of Class 2 NICs. There is scope for further research that looks specifically at understanding and experience of dealing with Class 2 NICs.

The 'irregular economy', evasion and fraud

While it is likely that, for some people, non-compliance with requirements may be associated with lack of understanding or confusion, others may purposefully seek to evade their responsibilities. In both kinds of circumstances, the activities of the people concerned may form part of what is known as 'the irregular economy'.

There is a substantial literature concerned with different aspects of the irregular economy and much of this has attempted one or more of the following:

- defining what is meant
- describing what work is done, and by whom
- measuring the financial value of the irregular economy
- constructing sociological explanations for the existence of, and practices within, irregular economic activities.

Looking first at the definitions and terminology used within this literature, there is considerable ambiguity and overlap. There are many terms which, in some way, attempt to characterise a number of forms of work which exist outside the mainstream of paid employment or formal self-employment. These include: the black economy, the hidden economy, the informal economy, the shadow economy, the underground economy and the ghost economy (see Harding and Jenkins, 1989). Work done within the economies thus described includes work unknown or wrongly reported to all or any one of the Inland Revenue, DSS, Contributions Agency or Customs and Excise. The concern for policy makers is the concealment of income from gainful work in the market economy (Hakim, 1992).

The authors' own preference is for using the term 'irregular economy'. This prevents the confusions that can arise as a result of the fact that much 'informal' work is done without any fraud or evasion, for example very low paid work, unpaid work, family help or caring work, and self-provisioning. This kind of work that is legitimately done without formal obligations for financial reporting and regulation has often been of special interest to social scientists. The focus of interest of this report is non-compliance of people who do have formal obligations to report their work, and this section thus refers to the 'irregular economy'. However, it is important to

understand the imprecision and overlaps in definitions within the literature reported here. Some of the literature makes further distinctions between ‘ghosts’ and ‘moonlighters’ in describing respectively, those who are working but unknown to the authorities, and those who are known, but engage in some work which is hidden from the authorities. Self-employed people who do not comply with NICs requirements may be among either group.

Measuring the irregular economy

The ambiguities and imprecisions of definition contribute to the problems that exist in trying to measure the overall financial value of the irregular economy. Official statistics about the numbers of people caught evading or cheating and/or the amounts of money involved cannot be relied upon as they are measures only of what is discovered. Qualitative studies are difficult to undertake. These problems of empirical research have led academic writers to use a variety of methods in an attempt to investigate and measure the irregular economy, or particular components of this such as tax evasion. Much of what is known about formal financial responsibilities comes from the tax literature.

Three kinds of studies can be distinguished: those based on **monetary measures**, those using **discrepancy measure** and those based on **direct measures**. **Monetary measures** and **discrepancy measures** use econometric techniques applied to large-scale data. **Monetary measures** examine the relationship between monetary aggregates and economic measures. **Discrepancy measures** look for discrepancies and anomalies in national accounts or other statistics, such as the difference between reported earnings and reported expenditure in the Family Expenditure Survey. **Direct measures** either involve asking people directly about their behaviour, such as how much tax they avoid, or modelling supposed behaviour on the basis of questionnaires about attitudes in an attempt to discern why people behave as they do. These approaches are explained further and discussed below. Although these explanations are somewhat technical, it is important that readers understand why all three types of measure are problematic. We summarise what conclusions might be drawn from such studies in respect of NICs non-compliance on page 125.

Turning first to **monetary measures**, these are dismissed out of hand by Dilnot and Webb (1988) and also by Smith (1986). These measures rely upon looking at ratios of monetary indicators and

economic measures. One example might be the relationship between the amount of cash in circulation and an indicator of economic activity such as Gross Domestic Product. The implied notion here is that a greater amount of cash in circulation (particularly as large denomination notes) relative to the economic activity reported indicates a larger 'irregular economy'. However, as the critics point out (Smith, 1986; Dilnot and Webb, 1988) no direct and casual relationship between such changes in monetary aggregates and evasive behaviour can be imputed.

Discrepancy measures may be more illuminating. For example, Dilnot and Morris (1981) examined the income/expenditure relationships of households reporting in the 1977 FES. They tried to estimate the size of the hidden economy and to identify characteristics of households likely to be participating in it. They concluded that self-employed people were among those likely to be participating. However, Hakim (1992) argues that two key assumptions commonly made in such estimates are wrong. The first wrong assumption is that people working in the black economy (sic) are all registered as unemployed, and the second wrong assumption is that tax would be payable on their earnings. People who are working for levels of pay below the lower earnings limits for national insurance and/or the relevant tax threshold may not be known to the authorities but are neither engaged in tax evasion nor accruing a contributions debt. They are, therefore, not a source of lost revenue. Some concentration of earnings just below the National Insurance lower earnings limits or just below the tax thresholds is likely to reflect two complementary pressures. First, there is the effect of the poverty trap on workers with low earnings - people may not be willing to increase their income because of the high effective marginal tax rates just above the threshold. Secondly, some employers seek to minimise National Insurance liability for their employees. Despite this, workers are often assumed to be committing benefit fraud and evading tax, and the self-employed are particularly likely to be labelled in this way (Hakim, 1989b).

Dilnot and Webb (1988) went on to take the particular example of the self-employed and looked again at the information available from national income and expenditure surveys. They raise doubts (as does Smith, 1986) about the likelihood of those engaged in the irregular economy actually agreeing to participate in such surveys, despite assurances of confidentiality. A further problem is that self-employed people may report **current** expenditure but reported income

information may be quite out of date. In general, they urge caution and sensitivity in the interpretation of such data.

Studies conducted by Pissarides and Weber (1989) and Baker (1993) also concentrate on self-employed people. However, they appear to ascribe **all** unreported taxable economic activity to self-employed people, and their approach has attracted some criticism (Eardley and Corden, 1996b).

Direct measures can also be problematic. The Government has undertaken some direct measures of tax evasion using its own resources. Smith (1986) describes an exercise undertaken by HM Inspectors of Taxes on 5,500 randomly drawn tax files of self-employed people. Experienced inspectors were asked to indicate whether they thought it was likely that a full investigation of the tax payer would produce additional tax. Their feeling was that there would be additional tax payable in some 20 per cent of cases. At that time the Inland Revenue were investigating some three per cent of self-employed cases each year (as now). However, this was an indicative exercise only and cannot be relied upon for accuracy.

Other authors have attempted to 'model' taxpayer behaviour econometrically. These statistical techniques are based on neo-classical economic concepts and assumptions about people's behaviour, for example, that people will always make accurate decisions which will have the consequence of maximising their self-interests. The models attempt to predict statistically how people will behave. These may be thought-provoking studies, but are based on assumptions rather than empirical research. Dean *et al.* (1980) discuss economic models developed to predict taxpayer behaviour. They point out that although economists postulate in such models that the higher the tax rate the greater the incentive to evade tax, the picture is more complicated. Those who pay tax at the higher marginal rates may get the greatest return for their evasion in real terms, but in relative terms evasion may be much more worthwhile to someone on a low income who keenly feels the need for extra cash. Dean *et al.* discuss the work of Allingham and Sandmo (1972) and criticise this and other similar work for assuming that individuals will always act as rational self-interested people: amoral, risk-averse and utility maximising. Allingham and Sandmo (1972), in the tradition of such an approach, weigh the benefits of evasion against the risks of detection and punishment. Dean *et al.* are sceptical of a model which assumes that people make

perfectly informed rational decisions which trade benefits against sanctions. Moreover, they argue, it cannot be possible to measure accurately factors such as the risk of detection. Finally, they question the assumption that all individuals are fundamentally amoral and utility maximising. The overall conclusion here is that it is not possible to model real people's likely behaviour, with mathematical accuracy, to produce predictions as to how they will respond to various circumstances in the future.

Dean *et al.*'s own work (1980) was an empirical study of what people thought about tax evasion. This was a small study conducted in 1977 among 424 adults registering for evening classes in one town. Dean *et al.* accept that their sample is not representative of the population generally, but offer their work as an attempt to cast light on likely factors in decisions about whether to evade tax or not. The questionnaire was designed to seek views on the factors which the researchers thought would be important in such decisions, such as whether the level of taxation and public expenditure were appropriate, issues of equity between themselves and people earning more, less and the same as themselves, the perceived consequences of evasion, the opportunity to evade, moral considerations and economic considerations based on need or greed.

There were only 15 self-employed respondents among the total of 424 in their study, and findings are not statistically significant for this group. One thing that does stand out, however, is that the self-employed people had a great sense of horizontal inequity - they felt they were paying too much tax compared with their peers in similar income circumstances but working as employees. The authors did not investigate this further, but it may be that self-employed people's receipt of two tax bills each year, which they must make arrangements themselves to pay, may induce greater awareness of the size of the tax demand, compared with employees who have smaller amounts of money deducted at shorter intervals, at source. We believe that the kind of considerations utilised by Dean *et al.* in this study might inform further work on evasion, but as yet, little such research has been undertaken.

There is an important caveat to be raised regarding any consideration of National Insurance evasion and avoidance in the light of tax studies, which is whether National Insurance is perceived in the same way as tax. There is a surprising lack of information about attitudes to and perceptions of NICs, discussed further in the next section of the chapter.

Drawing together what can be learned from the literature on estimates of and participation in the irregular economy, the following points are important. Estimates of the size of the overall irregular economy are variable, and may be of little value for policy initiatives (Hakim, 1992). Discrepancy measures do point to self-employed people as those who have special opportunities to engage in activities outside the regulated economy. However, these studies are all problematic, and such findings must be approached with care. Finally, measures have often been developed from the special perspective of tax evasion. We do not know whether National Insurance is perceived as a tax, and thus whether this approach is directly relevant.

Among the people concerned, those who are aware that they are not complying with Class 2 NICs requirements may well perceive their activities more in terms of the kind of non-reporting of circumstances, or 'fiddling', that is characterised as benefit fraud. We therefore go on to look at what is known about benefit fraud.

Benefit fraud

The extent of benefit fraud is contested, although all commentators acknowledge its existence. The recent Benefits Agency enquiry (Benefits Agency, 1995) shows that non-declaration of earnings was one of the main sources of 'confirmed' fraud for unemployed claimants and lone parents on Income Support. However, the amounts of undeclared income are not reported. It is not possible from this published source, therefore, to assess how many people would have been liable to pay contributions.

Qualitative studies of people on low benefit incomes have consistently shown that working while on benefit, and not declaring earnings, is one of a range of responses of people struggling to meet household needs from their resources (for example, Pahl, 1984; Cook, 1989; Dean and Taylor-Gooby, 1992; Jordan *et al.*, 1992; Evason and Woods, 1995). However, it is not possible from such studies to elicit general estimates of the amount of illegal working or the amount of NICs which are lost. Many of the jobs that are cited by respondents might fall within a definition of self-employment though, again, it is not possible to estimate the proportions of these compared with jobs as employees. Furthermore, there are no estimates of the amounts of money earned or the contribution these make to household budgets and living standards. Nevertheless, it is clear from people's accounts that they perform an important function in meeting the perceived needs

of families, both for basic purchases such as food, clothing and fuel, and for the occasional 'extras' such as outings and presents.

Pahl's (1984) ethnographic study of work in the Isle of Sheppey is useful in gaining an understanding of the motivations behind what he calls people's 'coping strategies' during a time of economic recession. Interestingly, his account was published before the economic upturn which characterised the second half of the 1980s. In his analysis, the prime motivation for 'hidden' work is to bolster benefit income or low wages. The implication is that not declaring income avoids the possibility of jeopardising other income.

Studies based on small samples do not provide any help in estimating the proportions of non-declaration of earnings from paid employment and from self-employment. The impression from Evason and Woods study (1995) is that most people with undeclared earnings among their sample derived this from paid employment rather than from working on their own account. Dean and Taylor-Gooby (1992) gave only one example of someone working for himself in a business activity though some of their sample were occasionally engaged in petty trading. Both these studies argue that earnings from work are generally very low. However, while Evason and Woods admit that the amounts are mostly above disregards levels, Dean and Taylor-Gooby contend that benefit entitlements would largely be unaffected.

Jordan *et al.*'s study (1992) found that working and claiming benefits or doing a second job and not declaring earnings was commonplace among the 36 households in their study. Part of the reason for this was that there was a large amount of 'unstructured, irregular' work available. Much is described as 'occasional, short-term, seasonal or contract work, or irregular 'agency' work' (p192). As such, 'men working in this way did not fit easily into the administrative categories used by the tax and benefits authorities' (p102). Those men in the study who referred to themselves as self-employed reported a number of situations. Some worked for themselves and did pay their own tax and contributions; some were registered with agencies which would find them occasional and varied jobs, and others worked as subcontractors or other forms of unprotected employment. It is not clear in this book which of the sample was undertaking some form of self-employed work and claiming benefits at the same time. The implication was that

undeclared cash work was generally common, but one man is quoted as 'having to sign off, sign on, sign off, sign on all the time...' (p105).

Among others, Jordan *et al.* (1992) and Evason and Woods (1995) argue that people already in work frequently have greater opportunities for working in the 'informal economy' than benefit claimants. They have the resources to travel and to buy or borrow supplies and equipment and have the required network of contacts through which to hear about one-off jobs.

Cook (1989) describes a wide range of 'fiddles' carried out by people already in work, covering the whole range of work:

...professionals, whether self-employed or not, may engage in moonlighting and 'jobs on the side' in exactly the same way as builders, plumbers, car mechanics, hairdressers, gardeners, electricians, caterers and bar staff (p 52).

Cook questions some of the rationales offered for evasion (of tax, contributions and VAT). She suggests that rather than tax acting as an imposition on people that stifles incentives and effort, which they then have an incentive to evade, a more appropriate picture is that 'effective rationales are self-interest and reciprocity' (p58). By reciprocity, Cook means the mutual benefit to both parties in cash jobs - the buyer is usually offered a lower price for the job, or a quicker service, and the worker avoids paying taxes. Cook notes a further rationale for fiddling - the assumption that everyone else is doing it. What is being identified here is a cultural consensus that doing jobs on the side, and thereby denying the state income from taxes, is acceptable behaviour. And within each type of employment arrangement, Cook also suggests that there is a widespread agreement on the level of fiddling that is 'fair'. What is being described is a culture which delimits what is acceptable and what is not.

Opportunities and sanctions

We conclude this section on the irregular economy by pointing to the opportunities available to self-employed people for avoidance of financial responsibilities, and the sanctions and punishments that might be expected to constrain opportunistic behaviour.

We might expect self-employed people, in general, to have greater opportunity than most employees to evade state financial regulatory control, although under-reporting of income by employees may also be widespread. The small study conducted in 1977 among 424 adults by Dean *et al.* (1980) indicated that most of these people thought small-scale evasion was easier, and possible for more people, than serious evasion.

Self-employed people are not obliged to submit their accounts or other financial information to independent audit in the way in which most limited companies are under the Companies Act 1985. Few self-employed people will have a full audit certificate on their accounts - the absence of a legal requirement and the cost of such an audit create little incentive for this. Some very large partnerships (say, lawyers or accountants) will submit themselves to such an audit - perhaps because of the issues of trust between business partners, and also because such businesses are more likely to seek significant external finance or be subject to regulation by professional bodies (Boden, 1996). This general absence of independent audit of information from self-employed people means that their earnings information must be taken on trust, albeit self-certificated as accurate. Alternatively, the state agencies making use of such information must attempt to verify its accuracy themselves, which is potentially expensive, time-consuming, and in policy terms may be counter-productive. This does not represent an argument for extending requirements for a formal full audit certificate - the Government has relaxed audit requirements for small limited companies as part of its deregulatory drive.

Refusal or inability to make payments is similarly more of a problem with self-employed people than with employees. Employees are, by virtue of the control exercised by and through their employer, accorded fewer opportunities to avoid making payments. It is this channel of control which makes PAYE and Class 1 NICs payment systems work well and relatively cheaply. Similarly, the Child Support Agency has found deduction from earnings orders effective in ensuring payment of child maintenance by parents in employment (Boden and Corden, 1996). Effecting payment from self-employed people is more difficult (Boden, 1996; Boden and Corden, 1996).

One of the balances against non-compliance and evasion might be sanctions and punishments. Models of tax evasion counterpoise the benefits of tax evasion (more money in pockets and a

smaller tax bill) against the threat of risk of detection. Since the 1970s the Inland Revenue has employed significant staff resources on the investigation of tax evasion. Despite such effort, only about three per cent of self-employed accounts are audited in detail each year (Smith, 1986). The Inland Revenue has no powers for random audit of taxpayers and must have a reason for choosing to investigate. For example, a trader's accounts might suggest that the common business ratios (such as profitability) are not as expected for a typical business in that line of trade, or significant bank deposits would not appear to be fundable from the results of the business. Initial enquiries may then be followed by inspection of books and records, one or more interviews, at which the taxpayer may be accompanied by an accountant, and, most probably, an agreement that there is additional tax payable. In most such cases the taxpayer and the Inland Revenue reach a private contractual agreement, whereby the taxpayer pays tax, Class 4 contributions, interest and penalties for the default in return for no further assessment being raised in respect of those liabilities. The taxpayer will also be asked to sign a statement that there are no further undeclared liabilities, and Inspectors may ask for a statement of individual worth, to be used as a benchmark in any future investigations. Interest is at an assumed commercial rate on the tax evaded from the date on which it should have been paid. Penalties may reach 100 per cent of the tax payable, but are typically abated for factors such as disclosure, co-operation, and the size and gravity of the offence. A typical penalty might be in the region of 20-30 per cent of the tax payable. (Details of Inland Revenue practice can be read in Simon's Direct Tax Service, continuously updated and published by Butterworths.)

Such investigations may place taxpayers under considerable strain, and can be expensive in terms of time and accountancy fees, but they are generally conducted informally and proceedings are only rarely taken to formal arbitration or even court. Only in larger cases where criminal fraud can be proven, or where lawyers/accountants are implicated, are cases likely to be taken to court. The primary aim of the Inland Revenue is to ensure the flow of income rather than punishment *per se*. Prosecutions by the Inland Revenue of self-employed people are rare, probably fewer than 50 per year. Most tax investigations are therefore private matters, involving a proportionate financial penalty as punishment and interest as financial restitution. Moreover, because the Inland Revenue is driven by concerns of cost-effectiveness it is increasingly the case that small accounts are looked at by comparatively junior staff or not examined at all. As described on page 70,

Inland Revenue PAYE audit investigation teams visit businesses to investigate labour use, and these may discover 'ghosts' - people unknown to Inland Revenue.

Customs and Excise do undertake 'control' visits of traders on a regular but fairly infrequent basis in order to identify mis-statements of VAT. Smith (1986) reported that about one trader in ten was found to have some mis-statement, and the VAT authorities were more likely to prosecute than the Inland Revenue. Benefit fraud investigations are also becoming more common, although relatively few of these appear to be directed towards the earnings declared by self-employed people. The Child Support Agency reported in 1995 that it had not yet investigated any self-employed people in respect of a statement of earnings (Boden and Corden, 1996). Concern about this issue was one of the factors leading the Social Security Select Committee to recommend that the agency be more closely allied to the Inland Revenue in order to take advantage of that organisation's abilities in this area (Social Security Select Committee, 1996).

Like the Inland Revenue, the Contributions Agency focuses on encouraging compliance rather than punishing evasion, and has recently reorganised its payments methods and debt collection service to reduce under-collection. Civil proceedings in the County Court may be pursued by the Agency's solicitors, and, for self-employed people, this may lead to bailiff action. It is considered by the Agency that a County Court judgement can be a severe sanction for some self-employed people, who risk losing business standing and their credit rating. No direct evidence has been found about the role of the threat of discovery of evasion in people's decisions about payments.

Enforcement of debt is a problem which the Inland Revenue have had for a number of years. The divisions with responsibility for tax assessment (Inspectors of Taxes) are now being integrated with the divisions with responsibility for debt collection (Collectors of Taxes) in order to ensure that these bodies of staff work more closely with each other, both assessing and collecting taxes in a co-ordinated way. The Child Support Agency has very serious problems with the level of payment arrears from self-employed parents (Social Security Select Committee, 1996). Following the Child Support Act 1995 child maintenance can now be pursued as a County Court Debt, which may affect a person's credit ratings. Attention is being drawn to possible effect on credit rating of child maintenance debt in the current advertising campaign. This is likely to be a greater threat to self-employed people who make substantial use of credit facilities, or those who value

'business standing' in their community. The threat has less meaning for those who do not make use of credit facilities within their business, for example some subcontractors.

Turning to VAT compliance, there are problems of failure to register by small businesses with turnover above the threshold, under-declaration of VAT by registered traders, false claims of exemption and large frauds by organised criminals. Failure to register may not however be a serious problem (Keith Committee, 1983). The Keith Report also found that less than one per cent of identified mis-statements of VAT liability were subject to penalties each year, and comparatively few VAT fraud cases brought to prosecution.

The 'carrots' apparently offered to those who comply with Class 2 NICs may be as important, or more important, than the 'sticks' perceived as punishments for non-compliance. The following section considers the rewards for compliance.

Rewards for compliance

The financial advantages from evading tax are readily recognisable. There may also be advantages from compliance - peace of mind and a sense of a moral obligation fulfilled (Dean *et al.*, 1980). Compliance with NICs may have additional value in that they are contributions to personal entitlements. Literature produced by the Department of Social Security and the Contributions Agency stresses that NICs count towards benefits. Academics have questioned the strength of the relationship between NICs and personal benefits.

Creedy (1981) finds it surprising that anyone should regard contributions as anything other than a tax. Dilnot and Webb (1988) indicate that they are under little illusion that National Insurance is anything other than another income tax, and that while reform of income tax has proceeded apace, 'NICs are a bad tax: complex, distortionary and inequitable' (p1) where little progress towards reform has been made. They relate how there have been many suggestions that income tax and National Insurance should be integrated, but point to objections from government that such change would lead to administrative upheaval and a potentially great rearrangement of the tax burden. Most importantly, the final remnant of the contributory principle would be lost: 'individuals may be happier to pay if they know what their money will be used for' (p2). In contrast to this, Dilnot and Webb suggest, the assessment and collection of Class 4 NICs through

assessment by the Inland Revenue may reinforce notions that contributions are a tax, and a tax which produces no hypothecated benefits as it has no insurance element. (An hypothecated tax is one in which revenue is specifically dedicated.)

The hypothecated nature of National Insurance contributions may therefore be beneficial, if some people pay because they perceive a real benefit from payment. Alternatively, as Skinner and Robson (1992) point out, the Treasury has never looked favourably on hypothecated taxes, not only because of the associated inflexibility in public expenditure, but also because knowledge of the application of funds may cause taxpayer resistance. The same may be true of National Insurance contributions. If people are opposed to the idea of collective welfare arrangements, feel that they derive little direct benefit themselves or prefer to make their own arrangements, then they may be less inclined to pay NICs.

The 'tax' or 'contribution' question is therefore important. If Class 2 NICs are perceived as a tax, then findings from some of the studies of tax evasion may be directly relevant. If Class 2 NICs are in some way distinguished from tax (even by virtue of the different administrative systems or name) then tax evasion studies might not be so applicable. For example, if people perceive that a contributions record is vital in order to claim an old age pension, then evaders may be making trade-off decisions about the potential value of that benefit against the cost of paying, or the potential return from alternative investment of the same money.

As pointed out earlier, there is little direct evidence of self-employed people's perceptions of Class 2 contributions. There is some relevant information about general attitudes to state welfare provision, and their perceptions and use of social security benefits, and this section goes on to look at each aspect in turn. Chapter Six described the extent to which self-employed people make their own private provision for financial security.

Attitudes to state welfare

Surveys of British social attitudes that have been conducted since 1983 show that the 1980s, in general, was a decade of rising support for state welfare services, including retirement pensions (Taylor-Gooby, 1991) and that support for higher levels of welfare spending has continued into the 1990s, even at a perceived cost of higher taxes (Taylor-Gooby, 1995). Self-employed people

generally are included within this trend; however some differences in their attitudes are apparent. In 1984, the minority who thought that government should reduce taxes and lower social spending was larger among self-employed people (12 per cent) than among employees (eight per cent) (Bosanquet, 1984). Similarly, in 1987, more '*petty bourgeoisie*' (see Chapter One) thought that government should reduce taxes and lower social spending than any of the other five analytical social classes, although still a small minority of nine per cent (Taylor-Gooby, 1987).

Nevertheless, by 1991/92 68 per cent of the *petty bourgeoisie* (sic) stated that pension provision for elderly people was essentially a state responsibility, and 78 per cent thought this about health care. Their support for state redistributive welfare was still high, although not as high as the enthusiasm shown by lower income groups (Taylor-Gooby, 1991).

Another important finding from the British Social Attitudes series is that generally, support for higher levels of welfare spending tends to reflect self-interest (Taylor-Gooby, 1995). Thus, prioritisation of benefits for government spending has been consistent, with greatest support for old age pension and disability benefits, which most people see a likelihood of eventually needing themselves. The *petty bourgeoisie* see the same priorities among benefits as other social groups.

We do therefore see reflections of the apparent commitment to ideals of independence and self-determination among self-employed people in this series, as well as a rather more punitive attitude towards poverty. In 1984, fewer self-employed people than employees thought that 'real poverty exists' (Bosanquet, 1984) and in the same survey, nearly half self-employed people agreed that benefits were too high and discouraged job search, compared with 37 per cent of employees. In 1987, the *petty bourgeoisie* were more likely than other social groups to see laziness/lack of willpower as a reason for people being in need (Taylor-Gooby, 1987); fewer thought that pensions should be awarded at the same level for everybody, and more thought that people who were well off should pay for better services. In the 11th Report in the series new questions were asked about the role of welfare outside state provision, but Taylor-Gooby (1994) concluded that the majority of the population still wanted good basic state services - private provision was seen as an acceptable way of topping up state provision. Only a minority of the population, he observed (1995), currently believe that those people on middle and higher incomes can claim to be overburdened with tax liabilities.

This series of social attitudes surveys offer contextual information about general support for government redistributive policies, and commitment to established benefit schemes. Certainly, there is slightly less commitment to state welfare among the self-employed, and more interest in independent provision, and rather less enthusiasm for paying benefits to people who are not working. The patterns seen here might suggest that although a minority of people in all social classes, employed and self-employed, will be less than enthusiastic about making regular contributions to state welfare, and there are likely to be rather more people who feel this way among the self-employed, there is not widescale attitudinal resistance among self-employed people. They still see the need for basic state welfare provision, and are prepared to contribute towards this, even if they expect to be able to finance additional provision themselves.

Turning to other sources of information which may throw some light on support for a general contributory scheme, there is little direct research evidence. Eardley and Corden (1996a) collected some information in their study of low-income families. They showed that non-payment of contributions did appear to be common. However, people's explanations were usually in terms of lack of information, disputed assessments, delays caused by budgeting and cash flow problems, and competing priorities for family expenditure rather than on the basis of lack of support for the overall scheme.

The Contributions Agency's own Customer Satisfaction Surveys are concerned with service delivery rather than policy, and there is little information about customers' attitudes to the overall scheme. There is one interesting finding in the analysis of customer complaints, however. Among those customers who complain, a substantial number are concerned about National Insurance rules: 15 per cent of complainants in 1994, and 34 per cent in 1995 (Craig, 1994, 1995). Customers of the Debt Collection Unit (DCU) were especially likely to complain about the rules, according to the 1995 survey (p112). Most of the DCU customers were self-employed. A more detailed analysis of the reasons for this level of dissatisfaction with the scheme might throw more light on attitudes of some self-employed people to their position in a contributory scheme.

Self-employed people as recipients of state benefits

The finding from the British Social Attitudes surveys, that people's support for further spending on state welfare does tend to reflect self-interest, is likely to be important. We might expect

people to be less motivated towards paying contributions if they did not expect any return for their money. It has been emphasised already, however, that we do not know how far self-employed people (or other members of the general public) understand the different funding bases of contributory, non-contributory and contingency benefits. It is our belief, based on previous studies of low-income families, living standards and take-up of benefits, that many people have only minimal understanding of the links between tax and contribution revenue, social security funding, and the links with entitlements to benefits. It is common, for example, for people to justify their claims to income-related benefits in terms of the NICs they have made in the past. For this reason, this section includes information about self-employed people's use both of contributory and non-contributory benefits, to see what may be learned from literature and research about self-employed people as recipients of state benefits, generally.

Class 2 NICs do not count towards Contribution-based Jobseeker's Allowance (formerly Unemployment Benefit). We have found no clear evidence as to whether this acts as a disincentive towards paying Class 2 NICs. There is some evidence that some self-employed people do not make clear distinctions between contributory unemployment benefit and income-related benefit for people out of work, or understand the different eligibility criteria, anyway (Eardley and Corden, 1996a). There is room for further work here. People who were previously self-employed and register with DSS as unemployed may be entitled to Income-based Jobseeker's Allowance (formerly Income Support). It is hard to find estimates of the numbers who do this, as the information is not routinely available in respect of the claimant count (*Hansard*, 1993). An enquiry by the National Audit Office in 1992 (NAO, 1993) found that approximately 13 per cent of Income Support recipients classified as unemployed were formerly self-employed. This included people whose ill-health or disability currently prevented them from working at their self-employed occupation, as well as a small proportion who were doing part-time self-employed work which brought such low earnings that they were entitled to Income Support (Corden, 1996).

Claiming Income Support can be problematic for some previously self-employed people (Brown, 1992; Eardley and Corden, 1996a). Those whose break in work is considered to be part of a normal pattern, for example seasonal workers, or time between a series of short-term contracts, may not be paid Income Support (Brown, 1994). Those who are prevented from working, for example construction workers in bad weather, may apply but their income is likely to be assessed

on the basis of the last 12 months' earnings, which may disqualify them (Brown, 1994). It can sometimes be hard to demonstrate available income when a business is being wound up (NAO, 1993) and at that stage, business assets or proceeds from disposal will be taken into account (Brown, 1994). Nevertheless, the above figures show that many self-employed people have recourse to Income Support at some stage. It might be worth exploring further whether feelings and experience of the Income Support system have any effect on their attitudes towards maintaining Class 2 NICs. A tentative suggestion, for example, is that if some people have entered self-employment because they have little other economic choice, and they are escaping low welfare benefits and unemployment via this route (see Staber and Bögenhold, 1993) they may see no security through buying entitlement to state benefits, (especially where payment confers no entitlement to unemployment benefit).

Class 2 NICs do count towards entitlement to sickness benefit and long-term invalidity benefit. There is apparently lower usage of these benefits by people who are self-employed, however, discussed by Brown (1992). Data on take-up of these benefits by self-employed people is not easily accessible. However, analyses of special tabulations provided by the Department of Social Security led Brown to suggest that less than three per cent of spells of incapacity for which sickness benefit was claimed were due to self-employed people in 1988-89, although 12-13 per cent of the labour force were self-employed. Brown also presented results from special tabulations which show that for years 1984-85, 1985-86 and 1988-89 between 5.6 and 6.9 per cent of intake of recipients were self-employed in their last job. During the same years 10-13 per cent of the overall labour force in Great Britain were self-employed. The DSS 1992 cross-sectional survey of invalidity benefit recipients confirmed that use of this benefit by people incapacitated for work during self-employment was still low. A few men (eight per cent) but hardly any women (two per cent) had been self-employed in their last job (Lonsdale *et al.*, 1993).

There is much still to learn about the apparent low use of contributory sickness and incapacity benefits by self-employed people. It may have much to do with incomplete contributions records. It may also be associated with levels of ill-health and disability among the self-employed population. Chapter Two showed that the evidence of the health characteristics of self-employed people is rather mixed. Another possible explanation is that some people prefer to continue to try to keep things 'ticking over' despite ill health, in order not to lose business opportunities or

contacts (Eardley and Corden, 1996a). In general, the Family Credit recipients interviewed by Eardley and Corden were dismissive about claiming benefits while sick. A common view was that managing short periods of illness was part of being self-employed. There is also evidence that some people do not recognise their eligibility, or meet problems with application procedures or demonstration of incapacity for work (Eardley and Corden, 1996a).

One suggestion is that people who were generally healthy, or tried to keep working through periods of illness, might be less inclined to worry about their contributions record. Sickness benefit would not be an incentive towards compliance for those who did not expect to apply, or did not realise they would be entitled. There is scope for further research on the use of sickness and incapacity benefits among self-employed people and possible links with Class 2 compliance. The exclusion of self-employed people from the industrial injuries scheme has attracted recent criticism and new attention (DSS, 1991; Brown, 1992). The construction industry and the agricultural sector both have a high proportion of the workforce working as self-employed, and show substantial incidence of industrial injury incurred by self-employed people. This might be a further area for investigation of disincentives towards making Class 2 NICs.

The main contributory benefit that self-employed people might expect to claim eventually is basic state retirement pension. Brown (1994) points out that among current retirement pensioners, most people with a history of self-employment (especially men) have probably achieved a full or nearly full basic state pension. Meager *et al.* (1994) have re-analysed the survey of Retirement and Retirement Plans conducted in late 1988 by OPCS on behalf of the Department of Social Security, to look at self-employment and incomes in later life. Their findings emphasise the importance of basic state retirement pension in maintaining the incomes of the current generation of pensioners who have had some history of self-employment. The ex-self-employed were more likely than average to be dependent on state pensions and benefits. Among just over 100 retired people with a history of continuous self-employment, 47.1 per cent of usual net weekly income came from state pension compared with 38.7 per cent among just over 600 people who had been continuously employed. We do not know, however, whether this dependency on state pension of today's elderly people who have retired from self-employment has any effect on the attitudes and plans of those who are younger and currently self-employed. If they anticipate being in a similar situation as their self-employed parents eventually, then we might expect those who

understood their parents' financial circumstances to be encouraged to maintain their own contributions record.

Eardley and Corden's (1996a) qualitative research with low-income self-employed people showed that there was general awareness of the need to think ahead towards retirement, and most people did see a link between paying contributions and drawing retirement pensions. Hawkes and Garman (1995) also showed that self-employed people do give considerable thought to financial security in retirement (discussed in the previous chapter). Their study showed there was confusion as to whether the state retirement pension scheme was a funded or pay-as-you-go scheme, however, and people's perceptions in this respect may affect what they think they are contributing towards. Other effects that might be influential are self-employed people's perceptions of the value of the pension. Townsend and Walker (1995) suggest that the state old age pension is perceived to have reduced in value in recent years, with the indexation by reference to inflation rather than national pay levels. We might also wonder what effect there has been on people's expectations of the value of their pension as a result of recent ministerial pronouncements about the future inability of the declining working population to continue to fund pensions. There is scope for further research into perception of state pensions by self-employed people, and possible effect on contribution compliance.

When we turn to evidence of use of income-related benefits, it is hard to gain an overall picture. Corden (1996) has brought together data available about self-employed recipients of the main means-tested schemes: Income Support, Housing Benefit, Council Tax Benefit, Family Credit and Disability Working Allowance, and reviewed what is known about take-up. There are considerable gaps in our knowledge here, but what evidence there is suggests that there may be considerable non-take-up of entitlements among self-employed people. Qualitative research has shown that some non-take-up has been associated with confusion and misunderstanding, failure to recognise formal status appropriately, problems in negotiating, and the time, effort and expense involved. There may be various links with compliance with contributions. For example, people who met problems claiming Income Support during a period out of work after self-employment, may be reluctant to re-engage with social security agencies again when they take a new opportunity as a self-employed person, especially if they believed that Income Support was funded through contributions. Various hypotheses of this kind might be worth pursuing through further

research. Eardley and Corden (1996a), studying low-income families, met a farmer who had decided to withhold Class 2 NICs to demonstrate his dissatisfaction with his latest Family Credit assessment. People may project their experiences in one administrative process into others that are technically unrelated.

This section of the chapter probably raises more questions than it answers. There is evidence of strong dependence on contributory state retirement pension among ex-self-employed people and realisation of the need to make pension provision among the currently self-employed. There is evidence of apparently low usage of sickness and incapacity benefits, however, and low take-up of means-tested benefits. There could be both incentives and disincentives here for Class 2 compliance, which in turn will depend on how far people understand how the social security system works, how they view their own position within it, their previous experiences of dealing with the DSS, and their expectations of future needs and circumstances. How far people respond to such incentives and disincentives, anyway, has not been investigated in the context of National Insurance contributions. There is much scope for new research here.

Conclusions

This chapter has thrown into sharp focus the fact that there are many gaps in the information available about the attitudes and understanding of personal financial responsibilities among self-employed people. Further research could help to fill some of these gaps.

There is evidence of lack of understanding, confusion and uncertainties about National Insurance liabilities among some self-employed people. Most of the research evidence comes from low-income self-employed people, where there are sometimes problems in recognition of employment status. There is need for further research on levels of understanding about contributions, and National Insurance in general, among the general population of self-employed people (also, we would argue, among people who are employees, or economically inactive).

Research on tax evasion and benefit fraud is difficult to conduct. Evidence that exists in these areas is hard to interpret in the context of Class 2 compliance because we do not know whether Class 2 NICs are perceived as a tax, or whether there is any cultural consensus on Class 2 non-compliance.

Patterns of use of contributory and non-contributory benefits among self-employed people are not well researched. There could be both incentives and disincentives here for Class 2 compliance, but little is known about this.

CHAPTER EIGHT

DISCUSSION

None of the literature and research reviewed addresses directly the question of compliance or non-compliance in payment of Class 2 NICs. The general lack of literature about social security for self-employed people reflects what Brown (1992) has identified as a 'policy vacuum' for this group, despite the remarkable growth in self-employment since the early 1980s. It was, nevertheless, surprising to find that so little is apparently known about how National Insurance contributions are conceptualised, or levels of understanding of liabilities and benefits within the overall scheme.

There is, however, considerable information available about the characteristics of self-employed people. In addition, there is literature available about tax compliance, benefit take-up, fraud, business management and small enterprise development which may help the Contributions Agency understand more about their customer base, and inform any further initiatives for encouraging compliance. This final chapter looks across the general findings from the review, and offers some suggestions to address the two key areas of interest: why do some self-employed people not register with the Contributions Agency, and why do some self-employed customers get into arrears with Class 2 contributions? The chapter ends by pointing to some clear gaps in information which might be filled, and areas for possible further research to help the Contributions Agency improve the registration of self-employed people and the collection of payments.

First, it is necessary to emphasise the extreme heterogeneity of the self-employed population. This is not a group characterised by general similarities in patterns of working and earning. Rather, there is wide variation in the reason for and route into self-employment, the nature of work undertaken, the scale and organisation of activities, and the levels of earnings achieved. Achieving, within a regulatory scheme, the compliance of such a wide variety of people may require a number of different approaches.

This review for the Contributions Agency has been written in accordance with their need for information to increase compliance with the current overall National Insurance scheme as it stands. The authors have therefore not addressed directly the issue of the suitability of the National Insurance scheme of contributions and benefits for the current self-employed. There are discussions in the literature about such suitability, and there is an argument that achieving and maintaining compliance in any scheme depends partly on the overall suitability of the scheme. The authors have not pursued such arguments here, however.

Why do some self-employed people not register with the Contributions Agency?

It seems likely that there are problems of:

- recognition of liability to register with the Agency
- understanding how to register, and achieving what is necessary, and
- disinclination to register.

We look at each of these issues in turn, but emphasise that suggestions made are often tentative or speculative, because further research is needed in many areas.

Recognition of liability

To comply with requirements people must recognise that people who are self-employed must register for Class 2 contributions, **and** that they are formally self-employed for the purposes of National Insurance.

There is some evidence of confusion and misunderstanding among some people about their formal employment status, including where they stand in respect of the distinctions between people who are in work and those who are out-of-work benefit claimants, and where they stand in respect of the employee/self-employed divide. Such misunderstandings have been observed mainly among people in transitional situations at the beginning or end of a period of formal self-employment, and among people on low incomes, often working at home in relative isolation, including some people from minority ethnic groups. There may also be some misunderstandings about employment status among family members who work together in formal or informal business partnerships.

Recognition of employment status and liability to register may depend very much on external stimuli. Some people may never perceive a need to think, independently, about their formal employment status or obligations, for example, a woman working at home, whose main financial resources come from the earnings of her domestic partner, or a pension or benefit. Others who have given such matters some thought may be confused. There are a number of specific 'grey areas' of ambiguity about employment status, where case law decisions have been inconsistent. It would not be surprising to find confusions about self-employed status or liability for Class 2 contributions among, for example, some subcontracted workers, some homeworkers, and people working in publishing, media and arts presentation.

Even among people who do understand that their earnings are categorised as self-employed, there may still not be recognition of liability to register for Class 2 NICs. For example, there are many people whose main earnings come from work as an employee, but have secondary earnings from self-employed work. It seems likely that some of these have assumed that they meet their full liabilities in respect of National Insurance contributions through their PAYE contributions, or have just never thought about their additional earnings in the context of National Insurance. People with secondary earnings from self-employment are distributed throughout the income range. Indeed, informal discussions with professional colleagues have identified a number of people to whom it had not occurred that their occasional work done privately, for fees, meant that they should register a Class 2 liability.

Achieving registration

It is likely that at least some people are put off registration by the practicalities involved. These have been mentioned, for example, in the Agency's Customer Satisfaction Surveys. Form-filling, telephone calls, preparation and presentation of appropriate personal and financial information may be experienced as time-consuming, or involve some financial or personal expense (accountancy advice, document presentation, or invasion of privacy). It is hard, however, from the research evidence that exists, to distinguish problems of practical procedure from problems of understanding.

Disinclination to register

There is likely to be a problem of avoidance of registration among some people who wish to conceal earnings, or see no benefit to themselves of paying contributions, but again, there is a need for further appropriate research here.

It is not possible to quantify the extent to which the above three factors contribute to non-registration since so little is known about how NICs are conceptualised, and whether people see these as an unwelcome tax, or a payment towards future financial security. There is evidence to suggest no widespread hostility among self-employed people to the idea of contributing to a collective welfare system, and some certainly do understand the need to maintain a contributions record. There is also evidence, however, that some people who could be categorised as self-employed have given little, if any, thought to National Insurance.

In addressing these problems much of the responsibility for helping self-employed people recognise their liability will fall to the Contributions Agency itself, if it is important to achieve full registration even among those people who are exempt from liability through low earnings. The literature suggests that membership of trade unions or associations for self-employed people is low, and it is possible that only about half of self-employed people employ an accountant to help them with financial obligations. Some of those who do use an accountant cannot expect to receive expert advice on matters to do with National Insurance, and their accountant may not be primarily interested in Class 2 NICs.

The initiatives taken by the Agency to identify and educate the customer base of self-employed people are likely to be of prime importance. A number of potential target groups have been suggested throughout the review, and the Agency will want to consider whether any further liaison with other agencies such as the Benefits Agency might be useful, (for example to identify people leaving a period of unemployment) or the Department for Education and Employment. The Agency is already moving forward in a programme of greater liaison with the Inland Revenue. At a more basic level, it might be useful to think how far understanding about the National Insurance scheme, generally, might be incorporated into the state education system, or in the transition from school to employment.

The Contributions Agency own Customer Surveys offer some points to areas that pose practical problems for self-employed people, and these might be investigated further.

Why do some people get into arrears with Class 2 contributions?

There are likely to be three main reasons for falling behind with Class 2 contributions:

- problems of managing payments from self-employed incomes
- prioritising resources on low incomes
- disinclination to continue payments.

There may be links between the above factors, for individual people.

Problems in managing payments from self-employed incomes

Incomes from self-employment are often subject to considerable fluctuation, along with trade cycles or seasonal changes in occupational activity. People have different levels of experience and skills in juggling incoming and outgoing money, and ensuring adequate cash flow for personal expenditure. Inevitably, some are more successful than others.

The Customer Satisfaction Surveys 1994 and 1995 show that self-employed people often report their dissatisfaction in terms of fluctuations in income, and the problem of maintaining payments from such incomes. We do not know how well the current payment methods suit people in different kinds of self-employment. The authors suggest that while direct debit arrangements may seem a good idea, to even out liabilities, some self-employed people may find problems here. In any one month amounts of income that can be diverted into bank accounts for personal spending may dip. Similarly, for self-employed people on the quarterly billing system, bills from the Contributions Agency may arrive at the same time as large business bills, or co-incide with fuel bills. A lower proportion of self-employed people than employees are tenants, who may have options to 'juggle' housing costs by letting rent slip into arrears occasionally in order to meet pressing bills.

Prioritising resources on low incomes

We have demonstrated that large numbers of people make only modest earnings from self-employment, indeed some trade at a loss. People who find it hard to stretch their resources to requirements tend to meet immediate needs first, and those with dependants are likely to prioritise family and household needs. Priorities will also be set in keeping up with regular commitments or paying large bills, if resources are strained. It seems likely that some families will see priorities in paying the mortgage, and household outgoings such as fuel bills, thus reducing bank balances or available cash to meet other commitments such as those to the Contributions Agency. Mortgage arrears are a serious threat of loss of home, and for some self-employed people business as well.

People who are trying to get businesses off the ground, or prevent business collapse, may divert money for personal spending back into their business, making it even harder to meet bills, and allowing bank balances to decrease. People who get into serious financial difficulty are known to see social protection as an area in which cut-backs can be made.

Disinclination to continue payments

Again, disinclination to pay is likely to contribute to arrears of Class 2 NICs for some people. If penalties are perceived only in terms of personal loss of access to future pensions or benefits, those who are optimistic about their health, or confident about their ability to meet their needs for financial security and retirement in other ways, may be prepared to take such a penalty. Those who understand that penalties may also involve visits from the bailiffs or County Court proceedings may be less likely to run such risks although some people feel they have little to lose here either. We have to emphasise again here, however, that these are only speculations, as there is so little knowledge about the conceptualisation and understanding of National Insurance contributions.

In terms of finding solutions to these problems, the Contributions Agency can do nothing directly about fluctuating incomes from self-employment, nor individual's customers' problems in prioritising resources to meet expenditure needs. However, it could be useful for the Agency to consult further with self-employed people to investigate whether the current payment systems are

the most appropriate, or whether there are alternative approaches that might be considered to help different kinds of self-employed people maintain payments more easily.

It is hard, again, to make suggestions about initiatives to encourage people who feel disinclined to maintain payments, since so little is known about self-employed people's perceptions of rewards and penalties in this area.

Gaps in our understanding, and areas for further research

The review of the research and literature points clearly to some major gaps in our understanding, the need for better information in some places, and areas where further research would be helpful.

At a general level, it would be useful for the Agency to investigate further access to national data sets, to learn more about the self-employed population. A great deal of information is available at the micro-level in national data sets such as the LFS, FES, GHS and FRS. These could be interrogated for the Contributions Agency, using appropriate definitions of self-employment to match liabilities for Class 2 NICs.

Secondly, better information about the needs of self-employed customers might be sought through the Customer Satisfaction Surveys, using more appropriate questions for self-employed people and seeking more useful information. It is hoped that the present review may suggest some avenues in this direction.

At a more specific level, there is almost no information available about perceptions, understanding and conceptualisation of the National Insurance scheme, among either employed or self-employed people. We just do not know whether people take into account aspects such as access to benefits and pensions as a result of their contributions, or whether people think more in terms of an imposed and unwelcome tax (or a mixture of both). We consider that further research is indicated here, and recommend that this is not confined to people who are currently self-employed, in view of the movement between employment sectors over a lifetime.

Another important area for further research is that of money management. The Contributions Agency needs to know whether Class 2 NICs are dealt with as business or personal expenditure, and how they fit into budgeting strategies at the household or business level.

Finally, the Contributions Agency may find it useful to start to develop themselves statistical estimations of the customer base, and the level of compliance. Going through such an exercise, with a rigour similar to that of the Department of Social Security in refining estimates of take-up of benefits, may be helpful in identifying further gaps in knowledge about the customer base, and monitoring the Agency's activities and achievements.

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